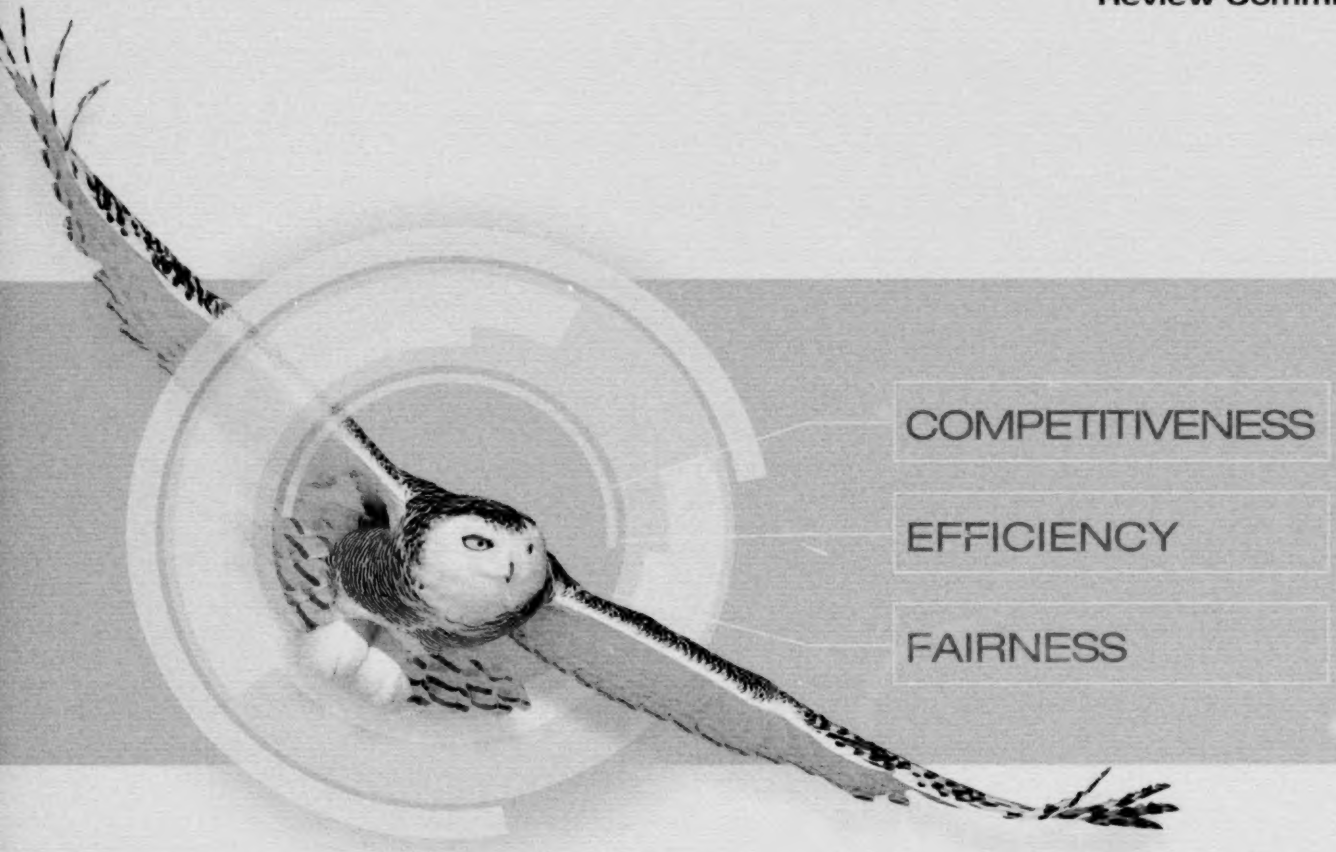
Final Report of the
Québec Taxation
Review Committee


COMPETITIVENESS
EFFICIENCY
FAIRNESS

FOCUSING ON QUÉBEC'S FUTURE

VOLUME 3

Current State of the Situation

Québec

Final Report of the
Québec Taxation
Review Committee

March 2015

FOCUSING ON QUÉBEC'S FUTURE

VOLUME 3

Current State of the Situation

Commission d'examen sur la fiscalité
Québec

Final Report of the Québec Taxation Review Committee

FOCUSING ON QUÉBEC'S FUTURE
Volume 3 – Current State of the Situation

Legal deposit – April 2015
Bibliothèque et Archives nationales du Québec
ISBN 978-2-550-72682-1 (PDF)
© Gouvernement du Québec, 2015

TABLE OF CONTENTS

INTRODUCTION 1

PART 1: TAX REFORMS 3

1. Tax reforms in Québec 5
   - 1.1 Commission royale d'enquête sur la fiscalité au Québec (1965) 5
   - 1.2 *Livre blanc sur la fiscalité des particuliers* (1985) 6
   - 1.3 Commission on Taxation and the Financing of Public Services (1996) 7
   - 1.4 Other public reflections 8
2. Federal tax reforms 9
   - 2.1 Royal Commission on Taxation (1966) 9
   - 2.2 The Wilson reform (1986-1991) 10
   - 2.3 Technical Committee on Business Taxation (1997) 11
3. Tax reforms in other countries 13
   - 3.1 Tax reforms that include broadening the tax base 14
   - 3.2 Reforms in Scandinavian countries 15
   - 3.3 Recent proposals 18

PART 2: FIELDS OF TAXATION WITHIN THE CANADIAN CONFEDERATION 23

1. The division of fields of taxation between the federal government and the provinces 25
   - 1.1 A division enshrined in the Constitution 25
   - 1.2 Three conditions for provincial taxes 26
2. The division of fields of taxation with municipalities 29
3. Tax harmonization 31
4. Fiscal autonomy 33
5. Agreements and transfers 35

PART 3: USE OF THE TAX SYSTEM IN QUÉBEC 37

1. The weight of taxation in the economy 39
   - 1.1 Québec compared to the OECD countries 40
2. Tax structure 43
   - 2.1 A comparison of tax structures between countries 44
   - 2.2 A comparison of tax structures between provinces 47
   - 2.3 Change in tax mix of the tax structure 49
3. The role of taxation in the redistribution of wealth and in the fight against equality 51
4. The incidence of taxation 55

PART 4: GOVERNMENT INTERVENTION THROUGH TAXATION 59

1. Economic growth outlooks 61
2. Taxation and economic growth 65
3. Government intervention through tax expenditures 75
4. Assessment of economic and fiscal impacts 79
    4.1 Statement about method 80
5. Effects of tax competition 89
    5.1 Tax competition sometimes justified, sometimes harmful 89
    5.2 The case of Québec 90
    5.3 Assessment of consequences 91

PART 5: THE MAIN CHARACTERISTICS OF PERSONAL INCOME TAX 93

1. The personal income tax burden 95
2. The breakdown of taxpayers by income group 97
3. The top marginal tax rate 99
4. Non-taxable taxpayers 103
5. The change in disposable income 105
6. The use of tax assistance for retirement savings 107
7. The preferential tax treatment of capital gains 111
    7.1 Background on capital gains taxation 111
    7.2 Analysis of the concentration of capital gains 112
    7.3 Lifetime capital gains exemption 114
    7.4 Tax expenditures associated with the preferential tax treatment of capital gains 116
8. The problem of implicit marginal taxation rates 117

PART 6: THE MAIN CHARACTERISTICS OF CORPORATE TAX 125

1. The corporate tax burden 127
2. The comparison of corporate tax rates 129
3. Payroll deductions 133
4. The overall taxation of dividends 135
    4.1 The principle of integration 136
    4.2 An international comparison 138
5. The evolution of corporate income tax rates 141
6. Corporate contributions to the government's own-source revenue 143
7. Corporate use of tax credits 145
    7.1 The main findings 145
    7.2 Certain key tax credits 147

PART 7: THE MAIN CHARACTERISTICS OF CONSUMPTION TAX 167

1. The weight of taxes on goods and services 169
2. A comparison of value-added tax levied in OECD countries 171
3. The scope of the value-added tax base 173
4. The levying of sales tax on certain tax-free goods in Québec 175
5. Specific taxation 179
   5.1 The specific tax on alcoholic beverages 180
   5.2 The specific tax on fuel 182
   5.3 The specific tax on tobacco products 184
6. Green taxation 185
7. The problem with collecting sales tax on e-business 189

PART 8: WEALTH TAXES, SOCIAL SECURITY CONTRIBUTIONS AND ELECTRICITY RATES 193

1. Wealth taxes 195
2. Social security contributions 197
3. Rates for public services: electricity rates 199
   3.1 Electricity rates 200

PART 9: COMPETITIVENESS OF THE PERSONAL TAX SYSTEM 205

1. The personal tax burden 207
2. Family disposable income 211

PART 10: COMPETITIVENESS OF THE CORPORATE TAX SYSTEM 213

1. Marginal effective tax rates 215
2. The competitiveness of Québec and its tax system 219
3. The use of certain tax credits 221

List of charts

CHART 1 Comparison of the tax burdens of Québec and certain OECD countries – 2012 40

CHART 2 Comparison of the tax burdens of Québec and the other Canadian provinces – 2010 42

CHART 3 Comparison of the tax structures of Québec and the OECD countries – 2012 45

CHART 4 Comparison of the tax structures of Québec and the rest of Canada – 2010 48

CHART 5 Change in certain tax revenues in Québec – 1981–2012 (tax revenues as a percentage of GDP) 50

CHART 6 Change in certain tax revenues in the OECD countries – 1981–2012 (tax revenues as a percentage of GDP) 50

CHART 7 Redistributive impact of taxes and transfers in certain OECD countries – mid-2000s 52

CHART 8 The weight of personal income tax – 2012 95

CHART 9 Top marginal tax rates in OECD countries – 2013 100

CHART 10 Combined (federal and provincial) top marginal tax rate by province – 2014 101

CHART 11 Implicit marginal taxation rates – Couple with two children 7 and 9 years of age 120

CHART 12 Density of implicit marginal taxation rates for all households 121

CHART 13 Weight of corporate tax in Québec and certain OECD countries – 2012 127

CHART 14 Corporate income tax rates in OECD countries – 2014 130

CHART 15 Dividend tax rates among OECD countries – 2014 139

CHART 16 Change in statutory tax rate for corporate income – 1981 to 2013 141

CHART 17 Evolution of the weight of income tax revenues in proportion to GDP – 1981 to 2012 141

CHART 18 Change in fiscal levies on corporations – 1970-1971 to 2014-2015 143

CHART 19 Change in the cost of tax credits as a proportion of fiscal levies on corporations –1990-1991 to 2014-2015 145

CHART 20 Proportion of total tax credits granted, by group of recipient corporations – 2011 146

CHART 21 The weight of taxes on goods and services in Québec and certain OECD countries – 2012 169

CHART 22 Consumption tax rates in OECD countries – 2014 171

CHART 23 VAT revenue ratios of OECD countries – 2012 174

CHART 24 Comparison of the price of certain alcoholic beverages among the most widely sold in Québec – 2014 181

CHART 25 Components of the price of a carton of 200 cigarettes 184

CHART 26 Annual caps and estimated distribution of the greenhouse gas emission units available for allocation without charge versus the emission units available to be sold 188

CHART 27 Global online retail sales 189
CHART 28 Individuals who purchased a good or service online 190
CHART 29 The weight of wealth taxes – 2012 195
CHART 30 The weight of social security contributions – 2012 197
CHART 31 Comparison of average electricity prices as at April 1, 2014 – Residential customers 201
CHART 32 History of electricity rate increases in Québec compared with the Québec CPI 202
CHART 33 Difference in tax burden between Québec and Ontario – 2015 209
CHART 34 Marginal effective tax rates on capital – 2014 216
CHART 35 Business location and operating costs – 2014 219
CHART 36 Tax competitiveness index based on Montréal costs 220
CHART 37 R&D tax treatment: Tax subsidy rate for US$1 of R&D, SMEs – 2013 223
CHART 38 R&D tax treatment: Tax subsidy rate for US$1 of R&D, large enterprises – 2013 223
CHART 39 Total software development costs – 2014 224
CHART 40 Total video game production costs – 2014 225

List of tables

TABLE 1 Top marginal rate applied to capital gains in Québec and the United States for a person living alone – 2015 20
TABLE 2 Change in tax burden, in Québec and certain other countries – 1981–2012 41
TABLE 3 Change in the weight of personal income tax in the tax structure, in Québec and certain other countries – 1981–2012 (weight as a percentage of total tax revenues) 46
TABLE 4 Labour force participation rates for Québec, Ontario and all of Canada – 2014 62
TABLE 5 Forecasts for Québec's potential economic growth 63
TABLE 6 Effect of reduced GDP growth on living standard growth (GDP per capita) 64
TABLE 7 Long-term gain in real GDP per $1 decrease in the tax burden 67
TABLE 8 Marginal cost of $1 of public funds 72
TABLE 9 Cost of certain tax expenditures – 2013(1) 78
TABLE 10 Summary of the assessments of the tax impacts for Québec of the tax credit for the development of e-business 79
TABLE 11 Fiscal impacts calculated using three methods, new recurrent operating expenditure of $20 million per year in the software publishing sector, 10-year total 86
TABLE 12 Tax assistance for businesses – Summary of fiscal impact assessment studies(1) 87
TABLE 13 Breakdown of taxpayers by total income group – 2011 97
TABLE 14 Non-taxable taxpayer rates – 1995 to 2011 103
TABLE 15 Growth in disposable income since 1981 by age in Québec, in constant 2010 dollars 105
TABLE 16 Shortfall and shortfall index based on taxes payable on retirement plan contributions – 2011 109
TABLE 17 Taxable capital gains by income group, Québec – 2012 113
TABLE 18 Tax expenditures associated with the preferential tax treatment of capital gains – 2013 116
TABLE 19 Example of a calculation of implicit marginal taxation rates – Couple with two equal incomes and two children 7 and 9 years of age – 2014 118
TABLE 20 Implicit marginal taxation rates for a single-parent family with two children – 2012 119
TABLE 21 Breakdown of households having an implicit marginal taxation rate above 60% by category of household and by income – 2014 122
TABLE 22 Statutory corporate income tax rates – General rates, 2000 and 2014 131
TABLE 23 Statutory corporate income tax rates of SMEs – 2014 132
TABLE 24 Payroll tax rates – 2014 133
TABLE 25 Integration mechanism for dividend taxation in Québec – 2014 136
TABLE 26 Combined maximum marginal tax rate for labour income and dividends in Québec – 2014 137

TABLE 27 Selection of tax assistance programs for the production of video games – 2014 151
TABLE 28 Investment tax credit rates based on the size of the business and the region where the qualified expenditures were incurred 154
TABLE 29 Research and development tax credits, federal and provincial, by enterprise size 157
TABLE 30 Comparison of the tax credit for Québec film and television production with that of Ontario and British Columbia 160
TABLE 31 Comparison of tax credits granted for foreign film production services in select provinces 162
TABLE 32 Consumption tax rates in Canadian provinces – 2014 172
TABLE 33 VAT rates on groceries, pharmaceuticals and books in European Union member states – 2015 176
TABLE 34 Revenue from specific taxes 179
TABLE 35 Specific taxes on alcoholic beverages 180
TABLE 36 Comparison of the different rates of specific tax on fuel in Québec 182
TABLE 37 Comparison of fuel taxation in certain jurisdictions(1) 183
TABLE 38 Profile of people in Québec who made online purchases 191
TABLE 39 Application of Ontario's electricity rate parameters to Québec – As at April 1, 2014 201
TABLE 40 Difference in tax burden between Québec and other provinces after applying to Québec the tax structures of other provinces 208
TABLE 41 Difference in tax burden between Québec and Ontario – 2015 210
TABLE 42 Difference in disposable income with other provinces for a couple with two children – 2015 211
TABLE 43 Change in the marginal effective tax rate on investment from 2005 to 2013 217
TABLE 44 Expenditure-based tax incentives 222

INTRODUCTION

The government established the Québec Taxation Review Committee in June 2014.[1]

After eight months of work, the Committee submits its final report, which contains a summary and six volumes.

☐ Volume 3

Volume 3, entitled ***Current State of the Situation,*** presents an analysis of the main characteristics of Québec taxation from different perspectives. This analysis led the Committee to develop the reform proposed.

From the different information available and the analysis it completed, the Committee determined the main characteristics of Québec taxation. This volume is divided into ten parts, each corresponding to a topic as follows:

— Part 1 pertains to **tax reforms.**

— Part 2 describes the **fields of taxation within the Canadian Confederation.**

— Part 3 presents the **use of the tax system in Québec.**

— Part 4 describes **government intervention through taxation.**

— Part 5 presents **the main characteristics of personal income tax.**

— Part 6 summarizes **the main characteristics of corporate tax.**

— Part 7 presents **the main characteristics of consumption tax.**

— Part 8 pertains to **wealth taxes, social security contributions and electricity rates.**

— Part 9 assesses the **competitiveness of the personal tax system.**

— Part 10 assesses the **competitiveness of the corporate tax system.**

---

[1] The Premier announced the establishment of the Québec Taxation Review Committee to analyze the Québec taxation system and propose the reform of it in his inaugural speech at the opening of the 41st Legislature of the National Assembly, subsequently confirmed in the 2014-2015 Budget. The Order in Council of June 11, 2014 officially created the Québec Taxation Review Committee and stipulated its mandate.

☐ Three sources

The Committee relied on three sources to analyze Québec taxation and determine the main elements that characterize it:

- External studies requested from Québec, Canadian and international experts on subjects the Committee wanted to look into more closely[2]
- Submissions, comments and suggestions submitted or prepared during the public consultation[3]
- Analyses and studies conducted at the request of the Committed by its secretariat and produced for the most part by the Ministère des Finances du Québec

☐ Extension of the volumes made public

In September 2014, the Committee made public three volumes prepared at the Committee's request by the Ministère des Finances du Québec and presenting respectively:

- An overview of the Québec taxation system[4]
- Québec's personal income tax system[5]
- Québec's corporate taxation system[6]

This volume is a logical extension of those three volumes.

---

[2] The complete list of submissions can be found in Appendix 3 of Volume 1 of this report. These studies are available in full in Volume 5 of this report (in French only).

[3] The complete list of submissions can be found in Appendix 2 of Volume 1 of this report. All submissions received by the Committee are available in Volume 6 of this report. The minutes of public forums can also be found in Volume 6.

[4] MINISTÈRE DES FINANCES DU QUÉBEC, *An Overview of the Québec Taxation System*, September 2014.

[5] MINISTÈRE DES FINANCES DU QUÉBEC, *Québec's Personal Income Tax System*, September 2014.

[6] MINISTÈRE DES FINANCES DU QUÉBEC, *Québec's Corporate Taxation System*, September 2014.

PART 1:
TAX REFORMS

The first topic addressed by the Committee was the major tax reforms proposed or undertaken in the past in Québec, Canada and other countries.

This section examines:

- — Tax reforms in Québec
- — Federal tax reforms
- — Tax reforms in other countries

1. TAX REFORMS IN QUÉBEC

In Québec, only three public reflections on tax reform have taken place since the 1960s. They were supplemented by the work of other public task forces on specific issues.

1.1 Commission royale d'enquête sur la fiscalité au Québec (1965)

The oldest of those reflections was the Commission royale d'enquête sur la fiscalité au Québec, which was created in 1963.

The Commission's president was Marcel Bélanger, and its secretary was Robert Bourassa, who later became the Premier of Québec. Its report was filed in 1965.

❑ Outline

The Commission's report was centered on three main directions:

- Abolishing certain tax credits and exemptions
- Broadening the tax base instead of increasing rates
- Harmonizing taxes shared with the federal government

The Commission suggested broadening the base of the sales tax rather than increasing its rate. Despite this proposal, the government increased the sales tax from 6% to 8% in 1967.

However, the government later adopted several other recommendations on licenses, permits and the fuel tax.

■ The collection of all tax revenues: already a concern

At the time, the report already indicated that the proliferation of exemptions and deductions was likely to make Québec's tax system more complex and less fair. There was a lack of fairness because some people were using measures that were not intended for them. So this is not a new phenomenon.

The Commission's report also stated that [Translation] "before considering raising taxes, tax authorities should make efforts to collect the amounts due to them by minimizing tax evasion."[7]

---

[7] COMMISSION ROYALE D'ENQUÊTE SUR LA FISCALITÉ DE LA PROVINCE DE QUÉBEC, *Rapport de la Commission royale d'enquête sur la fiscalité : instituée par les arrêtés ministériels 372 du 12 mars 1963 et 545 du 3 avril 1963*, Québec, R. Lefebvre, Imprimeur de la Reine, 1965.

1.2 *Livre blanc sur la fiscalité des particuliers* (1985)

The second major public reflection on taxation was a white paper on personal taxation that was made public in 1985.[8]

The white paper was prepared under the authority of Jacques Parizeau, who was then Minister of Finance.

It was published following a general reform of taxation for local governments and a comprehensive review of corporate taxation.

❑ Outline

Already at the time, the government noted that:

- Personal taxation represented an excessive burden in general.
- Québec income taxes were more progressive than they were elsewhere in Canada.
- The taxation system and the social transfer system had a number of inequities and inconsistencies.

In the white paper, the government set out the following objectives:

- Treat taxpayers as fairly as possible
- Simplify tax administration and make taxation easier to understand
- Guarantee a minimum living standard for everyone
- Levy a net contribution that is based on the ability to pay

Three reform options with common elements were presented. Each option aimed to reduce marginal tax rates.

One of the options was extending the sales tax to all consumer goods, except for food, prescription drugs and professional services.

■ First use of the general equilibrium approach

For the first time, with this white paper, the government was relying on a general equilibrium approach to present an economic analysis of the reform.

The analysis, which was produced by Bernard Fortin and Henri-Paul Rousseau in cooperation with Pierre Fortin, included a calculation of economic losses due to taxes and of economic losses associated with the implicit taxation of benefits, as well as the impacts on production and employment, among other things.

---

[8] MINISTÈRE DES FINANCES DU QUÉBEC, *Livre blanc sur la fiscalité des particuliers*, 1984.

1.3 Commission on Taxation and the Financing of Public Services (1996)

This commission was presided by Alban D'Amours and was created in 1996 in preparation for a socio-economic summit. Due to the urgent need to intervene, the Commission's mandate was only five months long.

The Commission's mandate was as follows:

- Identify the general directions that should guide the government in increasing the efficiency, fairness and competitiveness of the tax system while promoting job creation and ensuring the optimal financing of public services
- Produce an opinion on the bill respecting the elimination of the deficit and a balanced budget
- Examine the relevance of creating a fund (or trust) to reimburse Québec's debt and suggesting terms of financing

☐ Outline

At the end of its mandate, the Commission made 72 recommendations. The main ones were as follows:

- File annually with the National Assembly a report on the cost of the government's tax expenditures and implement a framework for the systematic reassessment of those expenditures
- Not increase the personal and corporate tax burden and, once a balanced budget is achieved, reduce the tax burden to improve the competitiveness of Québec's system
- Replace corporate income taxes with a business transfer tax
- Review the taxation of capital gains by making capital gains fully taxable, in coordination with the federal government.[9]

---

[9] COMMISSION ON TAXATION AND THE FINANCING OF PUBLIC SERVICES, *Working together for a responsible Québec: Report of the Commission on Taxation and the Financing of Public Services*, Québec, 1996.

1.4 Other public reflections

In addition to those three reflections on Québec taxation, other public task forces looked at specific aspects.

☐ Task Force on Tax Assistance for the Resource Regions and the New Economy

This task force was created in 2007 and presided by Robert Gagné.

Its mandate was to analyze the impacts of tax assistance measures for manufacturing businesses located in resource regions and of tax credits for businesses of the new economy located in designated sites.

For resource regions, the task force recommended replacing payroll tax credits with investment tax credits.[10]

For the new economy, the task force recommended replacing tax credits based on designated sites with targeted tax credits for multimedia and e-business.

☐ Task Force on Business Investment

This task force was created in 2007 and presided by Pierre Fortin.

Its mandate was essentially to help the government identify means of increasing investment to support economic growth.

The task force's recommendations included the following:

- Immediately abolish the corporate capital tax
- Decrease the general corporate tax rate to 10% instead of applying a generalized investment tax credit[11]

☐ Task Force on Fees for Public Services

This task force was created in 2007 and presided by Claude Montmarquette.

Its mandate was essentially as follows:

- Compare user fees in Québec with those in other jurisdictions
- Propose the key principles on which the government should rely to establish a user fee policy covering the entire public sector
- Propose new possible fields for setting user fees and their application
- Propose a process to systematically review different types of user fees, e.g., in light of the rising cost of services or based on the consumer price index[12]

---

[10] TASK FORCE ON TAX ASSISTANCE FOR THE RESOURCE REGIONS AND THE NEW ECONOMY, *On Equal Terms – Report of the Task Force on Tax Assistance for the Resource Regions and the New Economy*, Québec, January 2008.

[11] TASK FORCE ON BUSINESS INVESTMENT, *Québec Welcomes Investment – Report of the Task Force on Business Investment*, Québec, March 2008.

[12] TASK FORCE ON FEES FOR PUBLIC SERVICES, *The Right Fees to Live Better Together – Report of the Task Force on Fees for Public Services*, Québec, March 2008.

2. FEDERAL TAX REFORMS

At the federal level, three major reflections on taxation have taken place since the early 1960s.

2.1 Royal Commission on Taxation (1966)

The Royal Commission on Taxation was created in 1962 and presided by John K. Carter.

It submitted its report in 1966, after four years of work. This extensive report was over 2,500 pages long.[13]

☐ Outline

The guiding thread of the Carter report can be summarized with the expression "a buck is a buck is a buck," which means taxation must be the same, regardless of the source of income.

Fairness was at the heart of the Commission's reflection.

According to the report:

— The taxable unit should be the family rather than the individual.

— Taxable income should include all sources of income—including capital gains, bequests, inheritances and strike pay—and be taxed on an overall basis.

— The government should eliminate preferential tax measures for the extractive sector.

— Indexation was not required for the tax system.

☐ Publication of a white paper

The report led to the publication of a white paper on taxation in 1969.[14]

It was a much more modest version of the tax changes proposed in the report of the Royal Commission on Taxation.

■ Major reform of taxation

This reflection then led to a major reform of taxation that started on January 1, 1972.

The reform included the start of the taxation of capital gains.

---

[13] ROYAL COMMISSION ON TAXATION, *Report of the Royal Commission on Taxation*, Canada, 1966.

[14] DEPARTMENT OF FINANCE, GOVERNMENT OF CANADA, *Proposals for Tax Reform* [white paper], November 7, 1969.

2.2 The Wilson reform (1986-1991)

From 1986 to 1991, the Mulroney government's Minister of Finance, Michael Wilson, implemented a tax reform that included three major phases spanning over several years:

- The reform of corporate taxes, following the US reform (1986)
- The reform of personal taxes (1987), including reducing the number of rates in the tax schedule and replacing several deductions with tax credits
- The reform of the federal sales tax, which led to the introduction of the GST (1991), with the purpose of redefining the tax base by putting more emphasis on consumption taxes as opposed to income taxes

2.3 Technical Committee on Business Taxation (1997)

The Technical Committee on Business Taxation was created in 1996 and produced its report at the end of 1997.[15] It was presided by Jack Mintz.

Its report followed in the steps of the Wilson reform and built on actions taken in relation to the corporate tax rate and the number of preferential tax measures.

Its mandate consisted mainly of the following:

- Improving the tax system to promote job creation and economic growth
- Simplifying the taxation of business income to facilitate compliance by taxpayers and administration by Revenue Canada
- Enhancing fairness in the tax system by ensuring that all businesses share the cost of providing government services

☐ Outline

The main recommendations were as follows:

- Reduce the general tax rate
- Mitigate the impact of a reduced tax rate for SMEs
- Reduce assistance for research and development, in conjunction with the reduction of tax rates on profits
- Eliminate the exemption for capital gains
- Provide a more neutral capital cost allowance

■ Tax-revenue-neutral recommendations

In addition, the Committee's mandate indicated that its recommendations had to take into consideration the financial constraints of the federal and provincial governments.

This meant the recommendations had to be tax revenue neutral.

---

[15] TECHNICAL COMMITTEE ON BUSINESS TAXATION, *Report of the Technical Committee on Business Taxation*, December 1997.

3. TAX REFORMS IN OTHER COUNTRIES

In addition to relying on many previously published research reports on the topic, the Committee asked the International Monetary Fund to contribute to its reflection on international trends in direct taxation.

The study is entitled *Tendances récentes et perspectives dans les réformes de l'imposition directe*.

The study is available in full in Volume 5 of this report (in French only).

Three series of recent tax reforms are addressed:

- Tax reforms that include broadening the tax base
- Reforms in Scandinavian countries
- Recent proposals

3.1 Tax reforms that include broadening the tax base

Over the past few decades, almost all OECD countries have made major structural changes to their tax systems.

The reforms have dealt with both personal and corporate income taxes. They generally consisted of reducing tax rates and broadening the tax base, following the measures taken by the United Kingdom in 1984 and the United States in 1986.[16]

The principle of broadening the tax base ensures the sustainability of revenue while minimizing the distortion effects associated with high rates.[17] In theory, revenue gains can be obtained, for instance through a widening of tax bases by:

— Reducing tax preferences through the elimination of certain credits and exemptions

— Standardizing the tax treatment of different categories of taxpayers, such as employed workers and self-employed workers, and different sources of income

— Re-examining the progressivity of the tax system, through the reduction of income tax rates and the reduction of the number of brackets in the tax schedule

— Reducing the corporate income tax rate and financing it through the reduction of preferential tax measures

— Exploring the possibility of taxing new bases

— Rebalancing sources of revenue through the selection of the most efficient sources

---

[16] Bert BRYS, Stephen MATTHEWS and Jeffrey OWENS, *Tax Reform Trends in OECD Countries*, 2011.

[17] Economic theory suggests that distortion effects created by taxes increase with the tax rate and that the response is non-linear.

3.2 Reforms in Scandinavian countries

Scandinavian countries implemented a dual income tax system in the early 1990s. This reform was introduced in Finland (1993), in Norway (1992), in Sweden (1991) and to a lesser extent in Denmark (1987). Other countries such as the Netherlands, Austria, Belgium and Italy also took steps in this direction.

The guiding principles of the dual income tax system are a combination of the following:

- Progressive taxation of labour income and retirement income
- Proportional taxation of business income and capital with a wide tax base and a lower tax rate

The progressive tax schedule for labour income and retirement income ensures that the system remains progressive.

This hybrid model combining the global tax system and the single-rate (or flat tax) system is characterized by a greater neutrality over time between beneficiaries and between types of investments.

Above all, the model provides a real opportunity for simplification and a perception of fairness as a result of the elimination of a series of tax expenditures.

Recent developments in dual income tax systems
Excerpt from the IMF external study[1]

Besides the base-broadening/rate-lowering reforms of the 1980s and the spread of VAT in the past 35 years, the introduction of dual income tax systems is perhaps the most noticeable and potentially important recent tax policy innovation, both conceptually and for its actual impact.

- Indeed, the flat tax reforms of the post-communist transition were not as radical as initially thought.
- When compared to the Hall and Rabushka flat tax, and given their main focus on income tax (regardless of wage and consumption taxes), they appear more like extensions of the rate-lowering/base-broadening movement (save a few noticeable cases).

The dual income tax system reforms, however, mark a clear shift in tax policy design and are well adapted to the globalization of capital markets, which is a key aspect of the current economic context. They can also be consistent with base broadening and rate lowering, and they constitute for most countries a less risky and radical alternative than other fundamental tax reform options.

Implementation of dual income tax systems

The dual income tax system was first implemented in Denmark in 1987. Sweden (1991), Norway (1992) and Finland (1993) followed suit, but none of these countries has a pure dual income tax system (see the table below).

- Sweden's and Norway's systems are generally regarded as being the closest to it, and Denmark is regarded as having drifted back towards a global tax system.
- No other country has explicitly made the shift to a dual income tax system, but many have borrowed the idea of preferential treatment of capital income.
- Austria, Belgium and Italy implemented a final withholding tax on interest income and dividends, keeping labour income and earned business-related labour income on a progressive schedule.
- The Netherlands also implemented a "Box" system, which is essentially a way to implement a schedular system whereby different types of income are taxed at different rates (with notably different rates for widely held companies and companies directly controlled by their shareholders).

Rates applied in dual income tax systems – Scandinavian countries

	Denmark	Sweden	Norway	Finland
Personal income tax rate				
– Labour income	Prog. up to 55.6%	31% to 57%	27% to 39%	23% to 54.25%
– Capital income	36.5% to 42%	30%	27%	30% to 32%
Capital gains	27% to 42%	30%	27%	30% to 32%
Corporate income tax rate	24.5%	22%	27%	20%

Source: Deloitte (*International Tax Highlights*).

Recent developments in dual income tax systems
Excerpt from the IMF external study[1] (cont.)

Although the idea of taxing capital income at a lower rate has attracted criticism on equity grounds, Nielsen and Sørensen (1997) looked at the efficiency/equity property of dual income tax systems. They concluded that higher taxation of labour income might be warranted on equity grounds, as returns on investments in human capital are otherwise not taxed.

While the debate is likely to continue, the fact that neither current systems nor dual income tax systems are applied in their pure form calls for caution. Indeed, the preferential treatment of capital income is already common in global income systems, notably to protect against inflation and to mitigate the consumption bias of income taxation.

The transition from global income tax systems to dual income tax systems has been the subject of interesting literature, notably for Canada (Mintz, 2006; Sørensen, 2007).

In general the transition involves first reducing and aligning all capital income tax rates and streamlining their treatments (notably with various exemptions), and then introducing rules to split the income of self-employed and other non-corporate business income into labour and capital components. In any case, careful and detailed planning is necessary.

[1] **Translation of an excerpt from the study *Tendances récentes et perspectives dans les réformes de l'imposition directe* available in Volume 5 (in French only).**

3.3 Recent proposals

☐ Mirrlees Review

In the United Kingdom, the Commission on Reforming the Tax System for the 21st Century, presided by Sir James Mirrlees, a Scottish economist who won the Nobel Prize in Economic Sciences in 1996, brought together a group of international experts and researchers in order to identify the features of a good tax system for any developed economy.

On this basis, the group of experts assessed to what extent the British tax system reflects a number of ideals. The group then considered how the system could be realistically reformed to head in that direction.

The Commission's work was published in two volumes. The first one is a collection of several studies that were prepared for the Commission on various topics, and the second one outlines the main findings arising from the Commission's work.[18]

The main findings of the group of experts were as follows:

— A tax system must be analyzed on a systemic basis, i.e., by considering the system as a whole.

— Out of a concern for transparency, earmarking tax revenues for specific expenditure programs without any spending constraints should be avoided.

— It is important to recognize that taxes cannot address all the objectives at the same time; for instance, a "green" tax does not necessarily need to be progressive.

— An ideal tax system should seek neutrality by taxing similar economic activities the same way so as to minimize the economic distortions associated with taxes.

— Progressivity of the tax system should be achieved efficiently by relying on solid data concerning income distribution and the sensitivity of income to changes in taxation. The impacts of taxes on taxpayers' decisions about their work habits, their predisposition to tax avoidance or their inclination to migrate to avoid a heavy tax burden are among the factors to be considered.

— Progressivity measured over an individual's life cycle rather than at a specific point in time provides a better picture of the true progressivity of a tax system.

---

[18] INSTITUTE FOR FISCAL STUDIES, *Dimensions of Tax Design, The Mirrlees Review*, Oxford University Press, 2011.

Features of a good tax system according to the group of experts presided by Sir James Mirrlees[1]

Income taxes

- Progressive income taxes with a transparent and coherent tax schedule
- A single integrated benefit for low-income or high-needs people
- Implicit tax rates that take into consideration changes in individual responses to taxes

Indirect taxes

- A value added tax that is uniformly applied for the most part and that minimizes the number of exceptions
- A tax equivalent to a value added tax in the case of services that are more difficult to tax such as financial services or housing services
- No taxes on simple transactions between individuals, such as transfers of ownership titles
- Additional specific taxes on alcohol and tobacco

Environmental taxes

- A tax to reduce carbon emissions
- A targeted tax to reduce road congestion

Taxation of savings and wealth

- No taxes on normal return on savings and additional incentives for retirement savings
- A tax schedule with similar treatment for all types of income, regardless of source, with an exemption for normal return on savings
- An integration mechanism for dividends received on corporate shares to take into consideration the taxes already paid by the corporation
- A tax on wealth transfers

Corporate taxes

- A single corporate income tax rate, with an exemption for normal return on investment
- Similar tax treatment for employed workers, self-employed workers and small business operators
- No taxes on intermediate inputs, except on the value of commercial and agricultural land

---

[1] James Mirrlees, et al., "The Mirrlees Review: Conclusions and Recommendations for Reform," *Fiscal Studies*, Vol. 32, No. 3, 2011, p. 353.

☐ President Barack Obama's 2015 tax reform proposal

On January 20, 2015, US President Barack Obama gave his sixth State of the Union address in which he proposed increasing taxes for the wealthiest and implementing measures to redistribute the benefits to the middle class. President Obama also proposed raising taxes and measures to limit tax evasion for high-income households. Among his proposals, two concerned the taxation of capital gains, namely:

- Increasing from 23.8% to 28%[19] the top rate applied to capital gains and qualified dividends for taxpayers in the highest bracket of the tax schedule
- Taxing capital gains at the time of inheritance, whereas these gains were tax-free in certain situations

Taxation of capital gains

Taxation on capital gain income is more advantageous than taxation on labour income, both in the United States and in Québec. However, Québec does not use the same calculation method as the United States for including capital gains in a person's income.

- In Québec and Canada, only half of capital gains are included in total income, and they are taxed at marginal rates of 25.75% in Québec and 24.22% in Canada for high-income taxpayers. In Québec, the top effective rate is 12.875%, and when combined with the federal rate, it reaches 24.985%.
- In the United States, all capital gains are included in total income, but they are taxed at a lower rate, namely 23.8% for high-income taxpayers if the assets in question have been held for over a year. With the proposal, this rate would increase to 28%.

TABLE 1

Top marginal rate applied to capital gains in Québec and the United States for a person living alone – 2015
(in percentage points)

	Top marginal rate on capital gains	Income inclusion rate	Applicable rate
Québec			
– Federal	24.22	50%	12.110
– Provincial	25.75	50%	12.875
Total	**49.97**	**50%**	**24.985**
United States			
– Federal – current	23.8	100%	23.8
– Federal – proposed	28.0	100%	28.0

---

[19] This rate is only for federal taxes and includes the 3.8% overtax to finance Medicare.

Taxation of capital gains on estates

In the United States, there are no taxes on capital gains upon death because there is no deemed disposition. For instance, an asset acquired for $1 million that is worth $5 million upon death can be bequeathed and sold by the heir without any taxes being due on the capital gain.[20]

Under President Obama's proposal, the assets of the deceased would be considered to be subject to a deemed disposition immediately prior to the person's death. Therefore, the capital gain would now be taxable in the deceased's income tax return.

This disposition already exists in Québec and Canada.

---

[20] In 2015, it is possible to bequest up to US$5,430,000 free of estate tax. The value of assets is the fair market value upon death. This provision makes it possible to accumulate fortunes in capital. Currently, all bequests between spouses are tax-free (with no limit), and each of the spouses can give and bequest to another person (often their child) up to US$5,430,000 tax-free, with a stepped-up basis price reflecting the fair market value upon death.

PART 2:
FIELDS OF TAXATION WITHIN THE CANADIAN CONFEDERATION

The second topic addressed by the Committee was fields of taxation within the Canadian Confederation.

This section examines:

— The division of fields of taxation between the federal government and the provinces

— The division of fields of taxation with municipalities

— Tax harmonization

— Fiscal autonomy

— Agreements and transfers

1. THE DIVISION OF FIELDS OF TAXATION BETWEEN THE FEDERAL GOVERNMENT AND THE PROVINCES

This section deals with the division of fields of taxation between the federal government and the provinces. It is essentially based on the analysis presented in the study *La fiscalité internationale et interprovinciale du Québec*, conducted at the request of the Committee by Gilles Larin, Lyne Latulippe and Marwah Rizqy, in collaboration with Carmina Chan of the Research Chair in Taxation and Public Finance.

The study is available in full in Volume 5 of this report (in French only).

1.1 A division enshrined in the Constitution

Sections 91 and 92 of the *Constitution Act, 1867* divided various powers between the federal and provincial governments. With regard to taxing powers, the Constitution includes the following provisions.

☐ No limits for the federal government and some limits for the provinces

The federal government is in no way limited in how it finances its activities since it has the power to raise "Money by any Mode or System of Taxation."[21]

However, the provincial governments face several limits. Their powers are restricted to "Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes."[22]

☐ Historical context

The reason for these constitutional limits is easier to understand in light of the historical context surrounding the creation of the Canadian Confederation.

At the time, the main legislative powers and fields of jurisdiction that involved major expenditures, such as the armed forces and postal service, were under the federal government's responsibility.[23] Federal fields of jurisdiction involved greater expenditures than the fields attributed to the provincial governments.[24]

In addition, the provincial governments had less financial responsibilities than they do today. Therefore, since the provinces had lesser financing needs, their taxing power was limited in the *Constitution Act, 1867*.

Note that one of the objectives of the division of fields of jurisdiction was to centralize the taxing power within the federal government and to finance provinces through federal transfers. Nevertheless, a province could still undertake more ambitious and more expensive projects by levying direct taxes itself.

---

[21] *Constitution Act, 1867*, 30 & 31 Victoria, c. 3 (U.K.), reprinted in R.S.C. 1985, App. II, No. 5, subs. 91(3), subject to the other provisions of the Act.

[22] Ibid. subs. 92(2).

[23] Joseph Eliot MAGNET, *Provincial Taxation Powers in Canadian Constitutional Law*, master's thesis in law, University of Ottawa, 1979 [unpublished], p. 3; see also *Constitution Act*, s. 91.

[24] Gérard V. LAFOREST, *The Allocation of Taxing Power Under the Canadian Constitution*, 2nd ed., Toronto, Canadian Tax Foundation, 1981, p. 2.

1.2 Three conditions for provincial taxes

For a provincial tax to be valid, it must meet three major conditions:

- The tax must be direct.
- The tax must consist of raising revenue for provincial purposes.
- The tax must be levied within the province.[25]

☐ The provincial tax must be direct

The Constitution does not define what a direct or indirect tax is. We have to refer to case law for a definition. The courts have historically relied on definitions provided by economists, and especially the definition introduced by economist John Stuart Mill.[26]

Mill's definition was published a few years before the creation of the Confederation.[27] The courts therefore concluded that there was no doubt that the "Fathers of Confederation" had this definition in mind when they used the expression "direct taxation."

The definition reads as follows:

> Taxes are either direct or indirect. A direct tax is one which is demanded from the very persons who, it is intended or desired, should pay it. Indirect taxes are those which are demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another: such as the excise or customs. The producer or importer of a commodity is called upon to pay a tax on it, not with the intention to levy a peculiar contribution upon him, but to tax through him the consumers of the commodity, from whom it is supposed that he will recover the amount by means of an advance in price.[28]

■ Analysis required

The impact of each new form of taxation has to be analyzed to determine whether it is direct or indirect. If the burden of the tax is transferred to a person other than the person who pays it, it is indirect.

At the time of Confederation, the courts applied this economic definition. However, over the years, tax systems have become more sophisticated and complex. The courts therefore had to nuance their test and apply it in a "legal" perspective rather than an "economic" one. From an economic standpoint, one may argue that almost every tax is indirect because merchants always adjust their prices to take into account the taxes they pay.[29] For this reason, we need to rely on the general trend and the purpose of the tax rather than on its economic impact in the strictest sense.[30]

---

[25] *Supra*, Note 3.

[26] Mill's definition was first introduced in *Attorney-General for Quebec v. Reed*, [1884] 10 App. Cas. 141, affirmed in Laforest, *supra*, Note 5, p. 78.

[27] Mill already enjoyed great authority and credibility at the time, as mentioned by the Privy Council in *Atlantic Smoke Shops, Ltd. v. Conlon*, [1943] App. Cas. 550, p. 563; as cited in *Ontario Home Builder's Association v. York Region Board of Education*, [1996] 2 S.C.R. 929, para. 34.

[28] John Stuart MILL, *The Principles of Political Economy*, Book 5, Chapter 3, Longmans, Green and Co., London, 1848.

[29] Peter W. HOGG, *Constitutional Law of Canada*, Student ed., Toronto, Thomson Carswell, 2006, p. 683.

[30] Principle established in several decisions, including *Ontario Home Builder's Association, supra*, Note 8, para. 41.

- **Relaxation of the definition by the courts**

The courts have relaxed the definition in light of the fact that tax systems are increasingly sophisticated and also the fact that provincial governments have increased levels of intervention. While the powers conferred on provinces in 1867 were considered to involve little costs, the situation has changed a lot since then.

The field of intervention of provincial governments has greatly widened, and provincial expenditures have also grown substantially. Federal transfers have not, however, followed this trend,[31] so provinces are now obligated to levy taxes to finance the expenditures falling under their jurisdiction.

Recognizing that the financing needs of provinces have evolved, the courts have relaxed the taxation limits imposed on them.[32] Based on the general trend and the purpose of the tax—rather than its ultimate economic impact, the definition of indirect taxation chosen by the courts is essentially limited to excise taxes and customs duties.

The overwhelming trend observed in case law since the beginning of Confederation gives provinces a wide and liberal interpretation of the restrictions imposed on them. However, the other conditions imposed by the Constitution must also be analyzed.

---

[31] Joseph Eliot MAGNET, *supra*, Note 4, p. 26.

[32] *Ontario Home Builder's Association v. York Region Board of Education, supra*, Note 8, para. 135 and following.

☐ The tax must be for provincial purposes

The condition of raising revenue "for provincial purposes" is of little importance and imposes virtually no real limit.[33]

It would seem that the only goal of this provision is to specify that the tax must be for the purpose of levying taxes for provincial fields of jurisdiction[34] and not for the purpose of a statute encroaching on federal jurisdiction and disguised in the form of taxes.[35]

☐ The tax must be levied within the province

The condition that the tax must be levied "within the province" is far more important.

For the tax to be valid, it is essential for the subject of the tax to be present in the province.[36]

Following the case law trend of relaxing the limits on provincial taxing powers, the courts have also widened the definition of what a "subject" is. Governments can impose taxes not only on persons, but also on their property, their operations or their profits within the province, regardless of the person's place of residence.[37]

This wide interpretation of the notion of territoriality therefore gives a lot of leeway to provincial legislatures.[38] Among other things, provinces can tax residents of the province for property located outside the province and non-residents of the province for property, operations or profits within the province.[39]

---

[33] Guy RÉGIMBALD and Dwight NEWMAN, *The Law of the Canadian Constitution*, 1st ed., Markham, LexisNexis, 2013, p. 325; see also Laforest, *supra*, Note 5, p. 75.

[34] *Reference re: Employment and Social Insurance Act (Canada)*, [1936] S.C.R. 427, p. 434 (Duff J., dissident), as cited in Régimbald and Newman, ibid.

[35] In *Attorney General for Alberta v. Attorney General for Canada*, [1939] App. Cas. 117, the purpose of the provincial tax on banks was to encroach on federal jurisdiction and not to raise revenue for provincial purposes, as explained in Guy Lord et al., *Les principes de l'imposition au Canada*, 13th ed., Montréal, Wilson Lafleur, 2002, p. 11.

[36] *Rex v. Cotton*, [1912] S.C.R. 469, p. 536 (Anglin J.), as cited in *Attorney General of British Columbia v. Canada Trust Co. et al.*, [1980] 2 S.C.R. 466 (Dickson J.).

[37] Principle developed in *Bank of Toronto v. Lambe*, [1887] 12 App. Cas. 575, as explained in Lord et al., *supra*, Note 17, p. 13.

[38] Subject to *R. v. Air Canada*, [1980] 2 S.C.R. 303, p. 316, the Supreme Court concluded that "In the case of aircraft operations, there must be a substantial, at least more than a nominal, presence in the Province to provide a basis for imposing a tax in respect of the entry of aircraft into the Province."

[39] Principle set out in *Firestone Tires and Rubber Company of Canada, Ltd. v. Commissioner of Income Tax*, [1942] S.C.R. 476, as explained in Lord et al., *supra*, Note 17, p. 14.

2. THE DIVISION OF FIELDS OF TAXATION WITH MUNICIPALITIES

The purpose of the division of fields of taxation set out in the *Constitution Act, 1867* is to allow both levels of governments to gather the resources they need to fulfill their respective obligations, according to the division of powers.

The power of municipalities is not enshrined in the *Constitution Act*. Municipalities were created by the provincial governments, which transfer powers to them. Provinces may transfer to municipalities the taxing powers that fall under their fields of jurisdiction.

In Québec, the taxing power transferred to municipalities mainly takes the form of property taxes.

3. TAX HARMONIZATION

In the Canadian taxation system, even though the federal government and the Québec government can act independently in determining their tax base and rate, the combined effects of the two systems need to be considered, since they ultimately apply to the same taxpayer.

Moreover, the interactions between the two systems require a certain harmonization of tax parameters.

Harmonization is required in some cases and desirable in other cases.

☐ Required harmonization

Harmonization is required when there would be an inconsistency for the taxpayer facing a non-harmonized system. This would be the case, for instance, for registered retirement savings plans.

Tax policy would be inconsistent if one government decided that the return on this kind of plan can grow tax-free until retirement and the other government decided that the annual return is taxable.

☐ Desirable harmonization

Harmonization is often desirable for reasons of simplicity.

A taxpayer can more easily understand tax provisions when a source of income is treated similarly in the federal system and the provincial system.

Harmonization is also desirable to avoid shifts in the tax base.

This is the case, for example, for the tax treatment of capital gains. Since the provinces started taxing them in 1972, they have consistently applied the same parameters to taxation on capital gains.

4. FISCAL AUTONOMY

The introduction of tax credits is the best example of fiscal autonomy.

A government may want to recognize a specific situation or intervene in a specific sector even though the other government may not have the same approach.

For example, the Québec government grants a tax credit to the multimedia sector, while the federal government is not required to do so. Conversely, the fact that the federal government no longer grants measures for labour-sponsored funds does not mean that the provincial government must do the same.

5. AGREEMENTS AND TRANSFERS

Since World War II, the federal government has made tax arrangements with the provinces.

☐ World War II: an agreement on the division of fields of taxation

In 1942, the federal Parliament adopted a statute on fiscal arrangements between the Dominion and the provinces. Under the terms of these five-year agreements, the provinces accepted to relinquish the collection of their direct provincial taxes to the Dominion, in exchange for which they were to receive grants from the Dominion.

The agreements were meant to be temporary wartime measures that the provinces were free to accept or refuse. However, the measure was maintained afterwards. In 1947, new fiscal arrangements were made between the Dominion and the provinces, which received grants whose amount was established under certain terms and conditions. Eight provinces signed these kinds of agreements, and only Québec and Ontario abstained.

This statute was a temporary arrangement for the duration of World War II.

☐ Following agreements

In 1962, all Canadian provinces, except for Québec, accepted a tax collection agreement granting the federal government the mandate to collect their taxes.

This type of agreement evolved over time.

Since 1997, the provinces have had greater leeway in implementing their own specific measures in terms of tax structure, tax rate schedule, surtaxes and tax credits.

■ Special Québec abatement

In 1964, the federal government gave the provinces the option of withdrawing from a number of joint programs, including hospital care and social assistance, in exchange for a transfer of tax points.

Québec was the only province to accept the offer, which resulted in the special Québec abatement. Still today, the special Québec abatement is equal to 16.5% of personal income taxes.

The abatement reduces the federal taxes payable by Québec taxpayers, thereby allowing Québec to levy higher taxes.

However, the abatement does not represent any financial gain for the Québec government. The 16.5% reduction in federal taxes for Québec taxpayers reduces the amount of federal transfers received by Québec for health care, post-secondary education and other social programs (13.5 points).

In addition, the Québec government repays the federal government the tax transfer related to the former program of youth allowances (3 points), which was abolished in 1974.

■ QST-GST harmonization agreement

The agreement concluded in March 2012 to more broadly harmonize the QST and the GST regimes further simplified the administration of the taxes.

Under the agreement, Québec agreed to:

- Eliminate the application of the QST on the GST
- Exempt financial services, which had tax-free status
- Abolish the restrictions on input tax refunds of big businesses (gradual abolition between 2018 and 2020)
- Maintain the base and the rules governing the QST harmonized with those of the GST/HST subject to 5% leeway, most of which (3%) has already been used

By way of compensation, Québec received $2.2 billion.

PART 3:
USE OF THE TAX SYSTEM IN QUÉBEC

The third topic addressed by the Committee was the use of the tax system in Québec.

This section examines:

- The weight of taxation in the economy
- Tax structure
- The role of taxation in the redistribution of wealth and in the fight against inequality
- The incidence of taxation

1. THE WEIGHT OF TAXATION IN THE ECONOMY

The weight of taxation in the Québec economy exceeds the average for the G7 countries and the OECD member countries.

OECD statistics on government revenues can be used to compare tax burdens between jurisdictions.

For comparisons with other countries, tax burden is measured using the existing tax revenue-to-GDP ratio. This is the most frequently used indicator for determining tax burden.

In 2012, the tax burden, measured using the tax revenues from all of Québec's public administrations, was 36.6% of Québec's GDP. That figure was 36.3% in 2011.

The increase in the weight of taxation in Québec in 2011 and 2012 can be explained in part by measures in the 2010-2011 and 2011-2012 budgets that were implemented to return to a balanced budget. Those measures included:

- An increase in the QST
- An increase in the health care contribution
- An increase in the specific tax on fuel
- A new system of mining duties
- A temporary increase in the compensatory tax on financial institutions

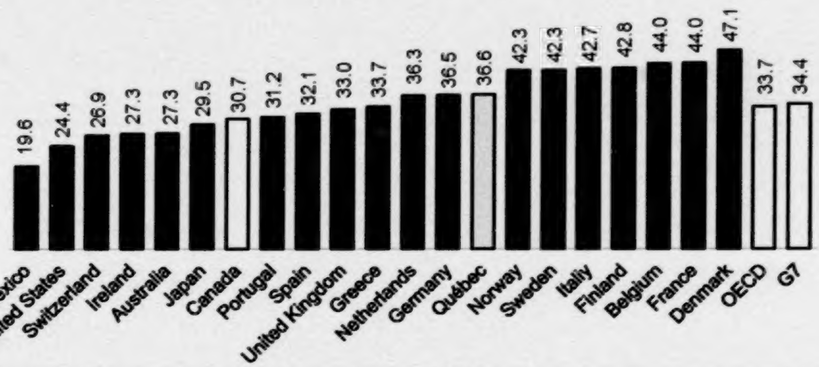
1.1 Québec compared to the OECD countries

Comparison with the OECD countries was done using data for 2012. In 2012, the weight of taxation in Québec was 36.6% of the GDP.

All countries with a tax burden above the OECD average were European countries. Québec's tax burden was significantly higher than that of the United States, where the tax burden was just 24.4%.

CHART 1

Comparison of the tax burdens of Québec and certain OECD countries – 2012
(tax revenues as a percentage of GDP)



Sources: OECD, data warehouse as at January 30, 2015, and Institut de la statistique du Québec, *Comptes économiques des revenus et dépenses du Québec* (2014 edition).

Change in tax burden from 1981 to 2012

Over the period from 1981 to 2012, the tax burden increased both in Québec and on average for the OECD countries.

The increase in Québec was 2.3 percentage points, whereas in the OECD countries it was 3.0 percentage points.

Nevertheless, over the same period, several countries reduced their tax burden.

- Among the G7 countries, Canada saw the greatest reduction. The tax burden as a percentage of GDP went from 33.3% to 30.7%, a reduction of 2.6 percentage points.
- The tax-to-GDP ratio also dropped in the United States. In 2012, it was 24.4%, which was 1.5 percentage points lower than in 1981.

Among the Scandinavian countries, Sweden recorded the greatest reduction, with the tax burden going from 45.0% to 42.3%, a reduction of 2.7 percentage points.

Comparison of Québec and Canada

In 1981, the tax burdens of Québec and Canada were relatively similar—34.4% in Québec and 33.3% in Canada.

Québec's tax burden increased while the rest of Canada's decreased, which resulted in a significant difference in 2012. The tax burdens in 2012 were 36.6% in Québec and 30.7% in Canada, a difference of 5.9 percentage points.

TABLE 2

Change in tax burden, in Québec and certain other countries – 1981–2012
(tax revenues as a percentage of GDP)

	1981	2012	1981–2012
Québec	34.3	36.6	2.3
Canada	33.3	30.7	−2.6
United States	25.9	24.4	−1.5
Sweden	45.0	42.3	−2.7
G7	31.6	34.4	2.8
OECD	30.7	33.7	3.0

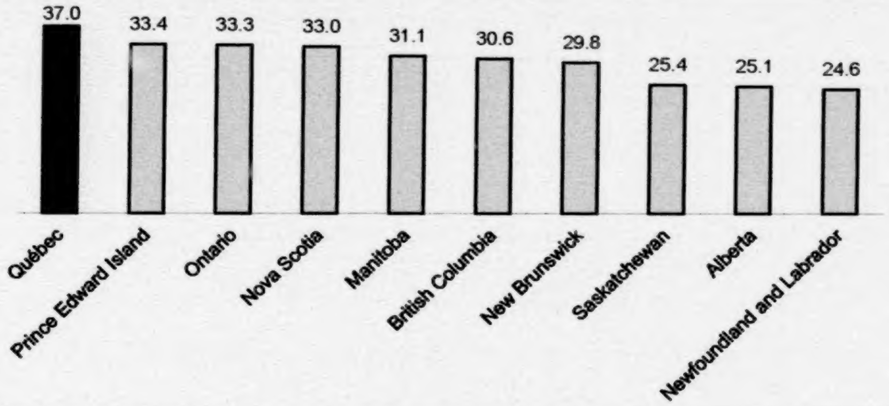
Note: The OECD average in 1981 was calculated using 26 countries, whereas that in 2012 was calculated using 34 countries.
Sources: OECD, data warehouse as at January 30, 2015, Institut de la statistique du Québec, *Comptes économiques des revenus et dépenses du Québec* (2014 edition) and *Comptes économiques provinciaux* (2011 edition).

Comparison between provinces for 2010

In 2010, Québec had the highest tax burden, at 37.0%. Newfoundland and Labrador had the lowest, at 24.6%.

CHART 2

Comparison of the tax burdens of Québec and the other Canadian provinces – 2010
(tax revenues as a percentage of GDP)



Source: Institut de la statistique du Québec, *Comptes économiques provinciaux* (2011 edition).

2. TAX STRUCTURE

Tax structure refers to the weight of the various methods of taxation in the economy. The choices a government makes between those methods of taxation for the purposes of collecting tax revenues are what determine tax structure.

Presented below are:

— A comparison of tax structures between countries

— A comparison of tax structures between provinces

2.1 A comparison of tax structures between countries

The average tax structure of the OECD countries is used as a comparison standard, despite the inherent limits of this type of comparison.

The recent change in taxation methods among the OECD countries indicates a certain convergence, which must be taken into account.

☐ Differences in comparison to the OECD average

Differences in comparison to the average structure applied by the OECD countries are as follows.

■ Personal income tax

In Québec, personal income tax as a percentage of GDP is 13.0%, which makes Québec one of the jurisdictions where personal income tax is highest. The OECD average is 8.2%—4.8 percentage points lower than the Québec figure. This means that the weight of personal income tax is 59.0% higher in Québec than across OECD countries.

■ Corporate income tax

The weight of corporate income tax in Québec is higher than the OECD average, with a difference of 1.5 percentage points.

■ Excise taxes and sales taxes

In Québec, the weight of these taxes as a percentage of GDP is 7.2%, which is under the OECD average of 9.4%. The difference is 2.2 percentage points, which means that the weight of these taxes is 23.2% lower in Québec than across OECD countries.

■ Social security contributions

As with the weight of excise and retail sales taxes, the weight of social security contributions in Québec is lower than the OECD average, by 3.3 percentage points.

■ Payroll taxes

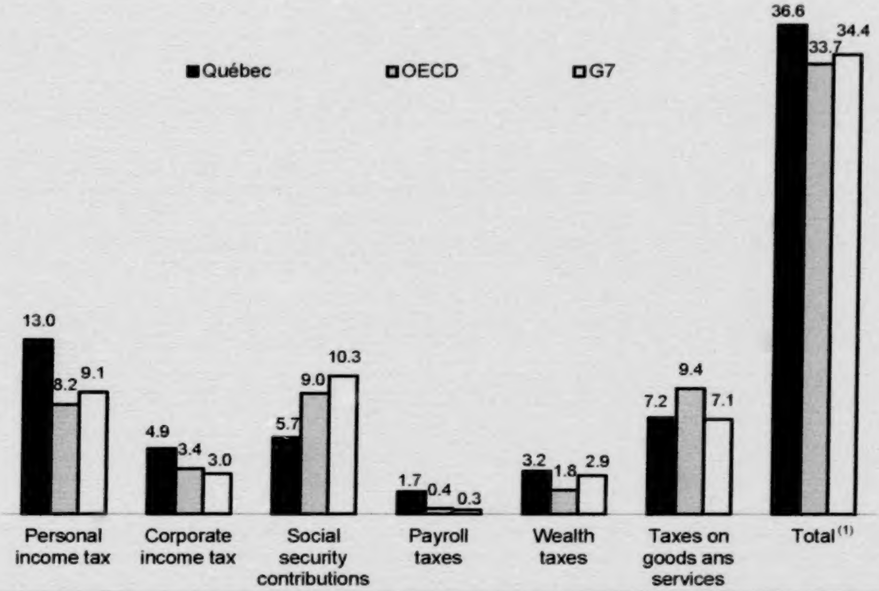
Payroll taxes are much higher in Québec than the average for the OECD countries.

■ Wealth taxes

In Québec, wealth taxes as a percentage of GDP are practically double (3.2%) the average for OECD countries (1.8%). Despite the lack of inheritance taxes and capital taxes, Québec's use of wealth taxes is high due to property tax levied at the local level.

CHART 3

Comparison of the tax structures of Québec and the OECD countries – 2012
(tax revenues as a percentage of GDP)



(1) The totals are greater than the sums of the parts because they include tax revenue sources other than the six categories presented.
Sources: OECD, data warehouse as at January 30, 2015, and Institut de la statistique du Québec, *Comptes économiques des revenus et dépenses du Québec* (2014 edition).

❑ Change in tax structure from 1981 to 2012

On average, the OECD countries saw a marked decrease in revenues from personal income tax as a percentage of total revenues.

This proportion fell, on average, from 23.9% in 1981 to 15.9% in 2012.

■ Among the G7 countries

In the United States, there was a reduction in the revenues from personal income tax as a proportion of total tax revenues. Nevertheless, the United States remained the G7 country with the highest weight of personal income tax.

■ Among the Scandinavian countries

Sweden had the greatest reduction in weight of personal income tax, from 40.0% to 28.2% of total of tax revenues.

■ In Québec

In Québec, the reduction was much less pronounced. The ratio of revenues from personal income tax to total tax revenues went from 37.1% to 35.5%.

■ In Canada

In Canada, the weight of personal income tax increased by 2.6 percentage points.

TABLE 3

Change in the weight of personal income tax in the tax structure, in Québec and certain other countries – 1981–2012
(weight as a percentage of total tax revenues)

	1981	2012	1981–2012
Québec	37.1	35.5	−1.6
Canada	34.0	36.6	2.6
United States	39.8	37.7	−2.1
Sweden	40.0	28.2	−11.8
Average, G7 countries	25.1	19.3	−5.8
Average, OECD countries	23.9	15.9	−8.0

Note: The OECD average in 1981 was calculated using 26 countries, whereas that in 2012 was calculated using 34 countries.
Sources: OECD, data warehouse as at January 30, 2015, and Institut de la statistique du Québec, *Comptes économiques des revenus et dépenses du Québec* (2014 edition) and *Comptes économiques provinciaux* (2011 edition).

2.2 A comparison of tax structures between provinces

A comparison of Québec with the other provinces identified several differences in their tax structures in 2010.

Those differences are as follows.

☐ Personal income tax

The weight of personal income tax was higher in Québec than in the rest of Canada.

In Québec, the weight of personal income tax as a percentage of GDP was 12.3% in 2010. This was 1.5 percentage points higher than the weight for the rest of Canada, which was 10.8%.

☐ Corporate income tax

The weight of corporate income tax[40] was similar to that in the rest of Canada.

☐ Taxes on goods and services (retail sales taxes and excise taxes)

The weight of taxes on goods and services was lower in Québec than in the rest of Canada, by 0.3 percentage points. In Québec, the weight was 7.2%.

---

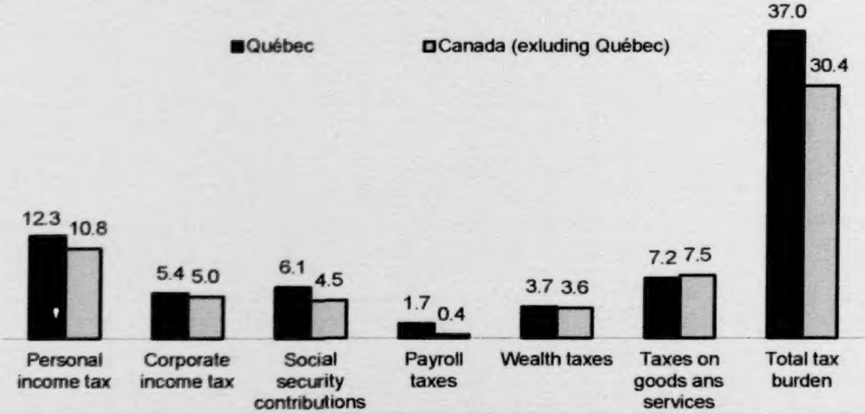
[40] Corporate income tax encompasses income tax, tax on the profits and capital gains of enterprises, taxes on wages and labour, and periodic taxes on the net assets paid by corporations and remitted to different levels of government.

❑ Social security contributions

The weight of social security contributions in Québec was much lower than across OECD countries; however, it was much higher in comparison with the rest of Canada, by 1.6 percentage points.

CHART 4

Comparison of the tax structures of Québec and the rest of Canada – 2010
(tax revenues as a percentage of GDP)



(1) The totals are greater than the sums of the parts because they include tax revenue sources other than the six categories presented.
Source: Institut de la statistique du Québec, *Comptes économiques provinciaux* (2011 edition).

2.3 Change in tax mix of the tax structure

The tax mix of a tax structure refers to the weight of each method of taxation relative to all taxes levied.

☐ Comparison with the OECD countries

There are significant differences between Québec and the OECD countries in terms of the weight of the three main tax bases used by the OECD countries.

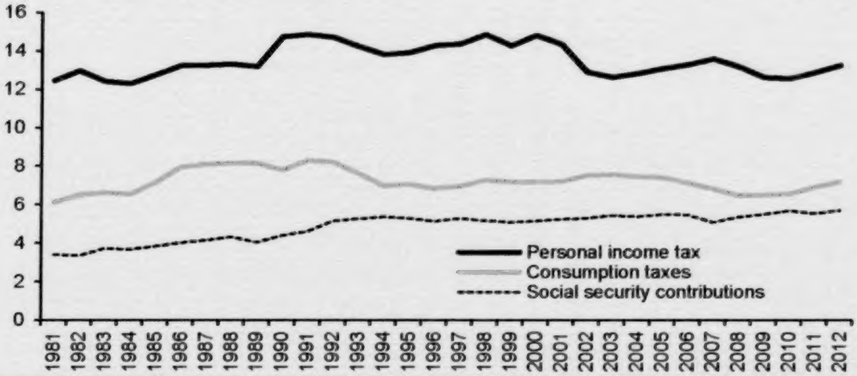
- Among the OECD countries, three tax bases have generated almost equal levels of revenue since the mid-2000s. Those tax bases are personal income tax, consumption taxes and social security contributions.
- In Québec, personal income tax remained the most used method of taxation between 1981 and 2012. It was used twice as much as the second most used method, consumption taxes.

Why this is may be explained in part by low labour mobility in Québec—worker mobility is much higher in the European Union.

It can be seen that European Union member states had a tendency to shift weight from personal income tax to consumption taxes.

CHART 5

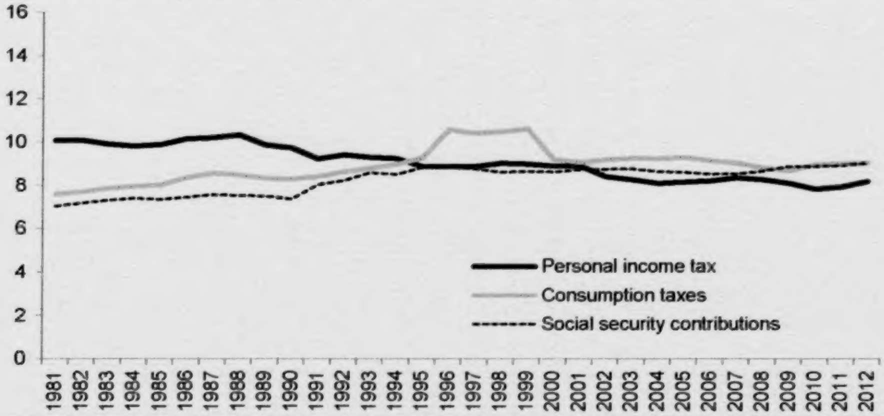
Change in certain tax revenues in Québec – 1981–2012
(tax revenues as a percentage of GDP)



Sources: OECD, data warehouse as at January 30, 2015, and Institut de la statistique du Québec, *Comptes économiques des revenus et dépenses du Québec* (2014 edition) and *Comptes économiques provinciaux* (2011 edition).

CHART 6

Change in certain tax revenues in the OECD countries – 1981–2012
(tax revenues as a percentage of GDP)



Sources: OECD, data warehouse as at January 30, 2015, and Institut de la statistique du Québec, *Comptes économiques des revenus et dépenses du Québec* (2014 edition) and *Comptes économiques provinciaux* (2011 edition).

3. THE ROLE OF TAXATION IN THE REDISTRIBUTION OF WEALTH AND IN THE FIGHT AGAINST EQUALITY

Taxation is more than a collection tool for funding public services.

By collecting tax revenue to fund public services, the government affects the behaviour of economic agents. It is therefore logical for the government to use the tax system to redistribute wealth and fight inequality.

Most developed countries use the personal income tax system to redistribute wealth in order to reduce income inequality.

Two methods are used to fight inequality and redistribute wealth:

- The implementation of progressive tax schedules
- The payment of transfers

The Measurement of Inequality in Income Distribution: The Gini Coefficient

The Gini coefficient is one of the most widely used indicators for measuring inequality in income distribution.[1]

The Gini coefficient is a composite indicator of income inequality. Statistically, the Gini coefficient presents the ratio of the cumulated proportion of the population, arranged according to income level, and the cumulated proportion of total income of the population.

The values of the Gini coefficient vary between 0 (perfect equality) and 100 (perfect inequality).

- When the coefficient is equivalent to 0, each person or household receives the same proportion of income.
- When the coefficient is equivalent to 100, the wealthiest proportion of the population receives all income.
- The scale of measurement often used by the Gini coefficient is from 0 to 1, i.e., the Gini index.

---

[1] Source: Ministère des Finances du Québec, 2012-2013 Budget – *Québec and the Fight Against Poverty: Social Solidarity*, March 2012.

❑ Public spending and transfers over taxation

While taxation certainly helps reduce inequality, several studies have shown that inequality is better fought through public spending and transfers.

■ Work of the IMF

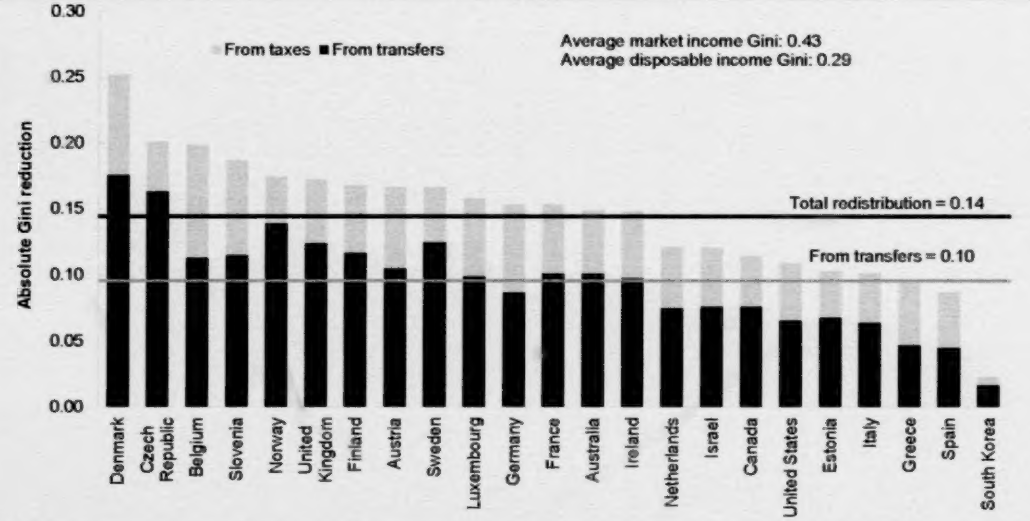
The chart below, which was produced by the IMF, shows that the average Gini index, which measures income inequality, is 0.43 before taxes and transfers and 0.29 after taxes and transfers, across the OECD countries for which the coefficient was analyzed.

To determine the relative contribution of taxes and transfers, Gini indices must be compared using like bases of calculation, which can be market income, total income (in which case government transfers are added to market income) or income after taxes and transfers.

According to IMF calculations, government transfers would reduce inequality by an average of 0.10 points when measured by the Gini index. In other words, government transfers would contribute to reducing inequality in the countries analyzed by more than 70% (0.10 points of 0.14 reduction points).

CHART 7

Redistributive impact of taxes and transfers in certain OECD countries – mid-2000s



Source: IMF, *Public Expenditure Reform: Making Difficult Choices, Fiscal Monitor*, April 2014, p. 33.

Other experts agree

In a report submitted to the Committee, political scientists Olivier Jacques and Alain Noël also state that equality and the redistribution of wealth are more affected by spending than revenue collection.

Their review of empirical data on the matter led them to conclude that the most progressive forms of taxation are not those that best ensure redistribution. The implementation of good public services and generous social transfers play a more important role in the fight against inequality.

They cite the example of two Scandinavian countries, Denmark and Sweden. These countries have been able to better redistribute wealth by using a less progressive income tax schedule than other countries, and by levying high consumption taxes and low capital taxes.

The countries' success in reducing inequality can be explained by the considerable sums they both invest in social programs.

These observations are consistent with the conclusion of Danish economist Henrik Jacobsen Kleven, a professor at the London School of Economics.[41]

According to Kleven, Denmark, Sweden and Norway invest widely in social programs that are complementary to the reality of working—such as daycare services, preschool services and care for seniors—and this offsets their relatively high tax expenses.

This explains in part why these countries are among the top in the world in terms of per capita income. According to Kleven, other factors such as high tax compliance and the Scandinavian social values and norms also contribute to the countries' economic success.

---

[41] See: Henrik Jacobsen KLEVEN, "How Can Scandinavians Tax So Much?," *Journal of Economic Perspectives*, Vol. 28, No. 4, 2014, pp. 77–98.

4. THE INCIDENCE OF TAXATION

The taxpayer to whom a method of taxation applies is not always the individual who in reality bears the tax burden.

☐ Legal incidence and economic incidence

When a government levies a tax, it determines which taxpayers must pay it. This is known as the legal incidence of the tax.

The economic or actual incidence of the tax refers to the taxpayers who actually bear the burden.

If a taxpayer shifts the taxes it owes to other taxpayers, it is those taxpayers who will bear the economic burden, even though the tax does not legally apply to them. For example, when a company is required to pay a certain tax, such as a payroll tax, it can make up for that cost by shifting the tax. It can do this by increasing the price of its products or by decreasing wages.

■ Complex identification

Identifying the legal incidence of a tax is easy because tax laws identify which taxpayers are responsible for paying each given tax.

Identifying the economic incidence of a tax is more complex because it can be difficult to determine whether an economic agent has shifted the tax to other economic agents and, if so, to calculate the extent to which that was done.

☐ Determinants of economic incidence

Tax shifting depends on several factors:

- The mobility of inputs
- The degree of competition
- The degree of market openness
- The size of the company on which legal incidence falls within the market in which it operates

An industry's oligopolistic organization makes tax shifting easier, whereas competition with foreign producers limits local producers' ability to shift the tax burden to consumers.

☐ Effect of progressivity

As long as the taxpayers who ultimately bear the tax burden are not clearly identified, it is difficult to determine the progressivity of the tax system.

To determine the system's actual progressivity, those on whom the economic burden of taxes falls must be identified.

- Where the weight of corporate income tax is borne by the corporation's shareholders, that tax can be considered progressive because the shares are held mainly by high-income taxpayers.
- Where the weight of corporate income tax is partly borne by employees, such as with payroll taxes, corporate tax is more proportional because the rate is uniform for all wage levels.
- Finally, where the weight of corporate income tax is borne by consumers, that tax is potentially regressive, since all taxpayers, both low- and high-income individuals, bear the same weight of tax in the prices of the goods and services consumed.

In the latter case, unlike with a consumption tax, no tax measure exists to support low-income taxpayers.

☐ Literature reviews

The following literature reviews and findings are based on a study commissioned by the Committee. Titled *L'incidence de l'impôt sur les bénéfices, des taxes sur la masse salariale et des taxes générales sur les transactions : revue des écrits et résultats pour le Canada*, 2000-2012, the study was conducted by Pouya Ebrahimi, Marylène Roy and François Vaillancourt of the Center for Interuniversity Research and Analysis of Organizations.

The study is available in full in Volume 5 of this report (in French only).

■ Findings

Several studies have concluded that corporate income tax is in large part shifted to lower-income economic agents.

Payroll taxes (including social security contributions) that are paid by employers are generally borne by employees. This may be because employers base their employment and remuneration decisions on the overall cost of remuneration, including payroll taxes and social security contributions.

According to the studies' authors, the fact that people in Québec are less likely to move to other provinces is part of the reason they may bear a larger part of the burden of corporate income tax and payroll taxes than employees in other provinces.

However, the authors note that the lack of available data makes it impossible to estimate the extent of tax shifting and to determine whether the proportion of the corporate tax burden that is shifted to employees is higher in Québec than in other parts of Canada.

Incidence of Corporate Income Tax: A Literature Review

L. Liu and R. Altshuler[1]

In this study, the authors suggest that a $1.00 increase in corporate tax revenue could decrease employee wages by approximately $0.60. The more concentrated the industry, the more significant that impact will be.

W. Arulampalam, P. Devereux and G. Maffini[2]

The authors of this study arrived at similar conclusions: a rise of $1.00 in corporate income tax would reduce wages by $0.49, in the medium to long term.

R. A. Felix[3]

In this study, the author found that a 1% increase in the marginal corporate tax rate reduces wages by 0.14% to 0.36%. The author also found that the corporate tax rate has a larger effect on wages as education levels increase.

R. A. Felix and J. R. Hines[4]

In this study, the authors evaluate the effect of corporate income tax on union versus non-union wages. The authors suggest that a $1.00 increase in corporate tax revenue reduces the median salary by $0.49. Unionized workers absorb 54% of the tax increase through wage reductions. This means that a 1% increase in corporate income tax would reduce union wage premiums by 0.36%.

F. D. Sebold[5]

This study seeks to determine whether corporations shift their tax burden and analyzes the mechanisms behind tax shifting. The author uses a model to assess the means of tax shifting: backward shifting (carried out through a reduction in employee wages or input costs) or forward shifting (carried out through an increase in product prices for consumers). Results suggest that 69% of a corporate tax burden increase is shifted. The amount shifted to wages is estimated at less than 80%, whereas the amount shifted to the price of goods produced is estimated at 154%, given the impact of prices on wages.

R. Dusansky and E. Tanner[6]

The authors of this study use similar data to that used by Spencer (1969; see following study). They found that corporations do not shift 100% of their tax burden to other economic agents—only 54% to 88%.

B. G. Spencer[7]

This study was one of the first to examine the incidence of corporate income tax in Canada. Based on data on the manufacturing sector from 1935 to 1964, the author concluded that manufacturing companies shift more than 100% of their tax burden to other economic agents, as seen in the different rates of return on capital depending on whether corporate tax is levied. However, the small sample size and the author's methodology have caused other researchers to question the validity of these findings.

---

[1] Li Liu and Rosanne Altshuler, "Measuring the Burden of the Corporate Income Tax Under Imperfect Competition," *National Tax Journal*, Vol. 66, No. 1, March 2013, pp. 215–237.

[2] Wiji Arulampalam, Michael P. Devereux and Giorgia Maffini, "The Direct Incidence of Corporate Income Tax on Wages," *European Economic Review*, Vol. 56, No. 6, 2012, pp. 1038–1054.

[3] R. Alison Felix, "Do State Corporate Income Taxes Reduce Wages?," *Economic Review*, Q2, 2009, pp. 77–102.

[4] R. Alison Felix and James R. Hines, "Corporate Taxes and Union Wages in the United States," NBER Working Paper No. 15263, August 2009.

[5] Frederick D. Sebold, "The Short-Run Shifting of the Corporation Income Tax: A Simultaneous Equation Approach," *The Review of Economics and Statistics*, Vol. 61, No. 3, 1979, pp. 401–409.

[6] Richard Dusansky and Ernest Tanner, "The Shifting of the Profits Tax in Canadian Manufacturing, 1935–65," *Canadian Journal of Economics*, Vol. 7, No. 1, 1974, pp. 112–121.

[7] Byron G. Spencer, "The Shifting of the Corporation Income Tax in Canada," *Canadian Journal of Economics*, Vol. 2, No. 1, 1969, pp. 21–34.

Incidence of Payroll Tax: A Literature Review

B. Dahlby[1]

The author examined several studies on the incidence of payroll taxes. He concludes that the burden of payroll taxes is in fact largely borne by employees.

É. Roy-César and F. Vaillancourt[2]

This study looks at the incidence of an increase in general payroll tax in Québec and Ontario. The authors conclude that a 1 percentage point increase in general payroll tax reduces wage growth by 0.5 percentage points in Québec and by 0.3 percentage points in Ontario. However, firm-specific payroll tax has a significant positive effect on wage growth. General payroll tax is levied on all companies consistently, whereas a firm-specific tax is related to the risk of workplace accidents and varies from company to company.

N. Marceau and F. Vaillancourt[3]

In this study, the authors suggest that a 1 percentage point increase in general payroll tax reduces wages, with coefficients of between −0.2470 and −0.0389. The authors also find that firm-specific payroll tax has a positive effect, with coefficients of between 0.0269 and 0.0266. When the incidences of general and firm-specific payroll taxes are combined, there is no significant effect on wages by an increase in payroll tax.

B. Holmlund[4]

This study also looks at the incidence of payroll tax on wages, but in the short term. Using data on the average wages of blue-collar workers in Sweden over a 30-year period, the author concludes that payroll tax is only partially shifted to employees, at least in the short term.

J. A. Brittain[5]

This was the first empirical study on the incidence of payroll tax. Using aggregate data for 64 countries, the author developed a model to determine the incidence of social security taxes and contributions on employee wages, all while controlling for the level of productivity per worker. The results suggest that the burden of social security taxes and contributions is shifted entirely to employees through wages that are lowered by the exact amount of the tax.

---

[1] Bev Dahlby, "Reforming the Tax Mix in Canada," *SPP Research Papers*, Vol. 5, No. 14, The School of Public Policy, University of Calgary, 2012.

[2] Édison Roy-César and François Vaillancourt, "The Incidence of Payroll Taxes in Ontario and Quebec: Evidence from Collective Agreements for 1985–2007," Center for Interuniversity Research and Analysis of Organizations, Scientific Series, 2010.

[3] Nicolas Marceau and François Vaillancourt, "Do General and Firm-Specific Employer Payroll Taxes Have the Same Incidence?: Theory and Evidence," *Economics Letters*, Vol. 34, No. 2, 1990, pp. 175–181.

[4] Bertil Holmlund, "Payroll Taxes and Wage Inflation: The Swedish Experience," *The Scandinavian Journal of Economics*, Vol. 85, No. 1, 1983, pp. 1–15.

[5] John A. Brittain, "The Incidence of Social Security Payroll Taxes," *The American Economic Review*, Vol. 61, No. 1, 1971, pp. 110–125.

PART 4:
GOVERNMENT INTERVENTION THROUGH TAXATION

The fourth topic addressed by the Committee was government intervention through taxation.

This section examines:

— Economic growth outlooks

— Taxation and economic growth

— Government intervention through tax expenditures

— Assessment of economic and fiscal impacts

— Effects of tax competition

1. ECONOMIC GROWTH OUTLOOKS

❑ Demographic changes, long-term economic growth and increased living standard

Demographic changes in Québec will have significant consequences on future economic growth. According to population projections published by the Institut de la statistique du Québec in September 2014, the population aged 20 to 64 will experience:

- Low growth between 2004 and 2017, at 0.2% growth per year, on average
- A decline between 2018 and 2030, at −0.3% growth per year
- A slight increase between 2031 and 2061, at 0.2% growth per year

Changes in this population provide a general picture of the potential labour force, or rather the shifting population base, from which Québec will draw its workers.

In 2030, the population aged 20 to 64 will again reach 2009 levels. Expected real economic growth will therefore be lower than that seen over recent years, in particular because of an increasing labour force shortage.

This weakened growth will have a direct impact on government revenues.

❑ Effect magnified by the labour force participation rate of older workers

Economic growth potential is also slowed by the low labour force participation rate of older workers in Québec. The rate in Québec is lower than in Ontario and in Canada as a whole.

- The labour force participation rate of men aged 60 to 64 was 53.9% in Québec in 2014, compared to 61.6% in Ontario and 59.5% in Canada.
- The labour force participation rate of women aged 60 to 64 was 44.0% in Québec in 2014, compared to 48.4% in Ontario and 47.5% in Canada.

The differences in rates are also significant for both men and women aged 65 to 69, and again for both men and women aged 70 and over. However, for all other groups, the differences in labour force participation rates are relatively small.

TABLE 4

Labour force participation rates for Québec, Ontario and all of Canada – 2014
(as a percentage)

Age groups	Québec	Ontario	Canada
15 to 24			
Men	67.1	60.8	63.8
Women	67.8	63.0	64.6
25 to 54			
Men	89.7	90.3	90.5
Women	84.2	81.2	81.9
55 to 59			
Men	75.8	78.3	78.2
Women	66.0	71.3	69.2
60 to 64			
Men	53.9	61.6	59.5
Women	44.0	48.4	47.5
65 to 69			
Men	25.1	34.8	32.4
Women	16.0	21.9	20.2
70 and over			
Men	8.5	10.7	10.3
Women	2.7	5.1	4.2

Source: Statistics Canada, Labour Force Survey, Table 282-0002.

☐ Slower economic growth

Real economic growth in Québec is expected to slow.

Between 1997 and 2013, average annual economic growth was 2.2%. Projections released by the Ministère des Finances du Québec show that real economic growth will average 1.3% for the period from 2021 to 2025.

According to a document recently published by the Desjardins Group Economic Studies team,[42] economic growth in Québec should average 1.28% between 2015 and 2024. It will increase slightly to average 1.60% between 2025 and 2035.

The anticipated average potential economic growth rate of 1.28% from 2015 to 2024 is based on labour force growth (+0.13%), capital growth (+0.64%), and efficiency gains and technological advances (+0.51%).

As a result of the major demographic changes, the proportion of Québec's projected economic growth between 2015 and 2024 that is attributed to labour force growth is relatively small (0.13%), especially when compared to the proportion of 0.64% for the period from 2005 to 2014.

TABLE 5

Forecasts for Québec's potential economic growth
(as a percentage)

	1995–2004	2005–2014	2015–2024	2025–2034
Potential GDP growth	2.54	1.66	1.28	1.60
Contributions by growth factor				
Labour	0.76	0.64	0.13	0.19
Capital	0.44	0.59	0.64	0.77
Residual growth(1)	1.34	0.44	0.51	0.64

(1) Growth explained by technological advances, training and efficiency gains.
Source: Desjardins, "Quebec's more optimistic demographic outlook does not reverse the forecast downtrend for economic growth. Fortunately, other levers could partially make up for this," in *Economic Viewpoint*, Economic Studies, December 16, 2014.

---

[42] Desjardins, "Quebec's more optimistic demographic outlook does not reverse the forecast downtrend for economic growth. Fortunately, other levers could partially make up for this," in *Economic Viewpoint*, Economic Studies, December 16, 2014.

■ Also more moderate growth of living standard

It should also be stated that within this context, the growth of living standard will also be more moderate.

While living standard grew by a real rate of close to 25% between 1997 and 2013, growth will be limited to 10% for an equivalent period based on real economic growth of 1.3%.

Similarly, in a scenario where average economic growth is 1.9% between 2014 and 2030, living standard will grow by a real rate of 21.2%.

TABLE 6

Effect of reduced GDP growth on living standard growth (GDP per capita)
(as a percentage)

	1997–2013[1]	2014–2030			
	Real	**Scenario 1**	**Scenario 2**	**Scenario 3**	**Scenario 4**
Average annual GDP growth	2.2	1.3	1.5	1.7	1.9
Real GDP growth per capita	25.4	10.2	13.8	17.4	21.2

(1) Statistics Canada, Economic accounts, CANSIM: Table 384-0038 (real GDP); Table 051-0001 (population).

2. TAXATION AND ECONOMIC GROWTH

The central objective of the tax system is to raise revenue to fund public services, such as education, health care and infrastructure.

However, the tax system is also used to encourage certain economic activities and to recognize specific situations.

This expanded role of the tax system requires adjudication concerning the primary goal of taxation.

☐ Methods of taxation and economic growth

According to economic theory, taxation has economic costs. With a view to spurring economic growth, the OECD advocates a tax policy reform that would see tax systems shift their reliance from the most damaging to the least damaging taxes.

Presented below are two methods for measuring the efficiency of the tax system and its impact on the economy:

- A method using a general equilibrium model
- A method assessing the marginal cost of public funds

❑ Method using a general equilibrium model

Useful information results from analyzing the changes made to the tax system in terms of the economic costs of various fiscal choices.

A general equilibrium model can be used to assess gains, in terms of GDP, that are associated with decreased taxes or user fees, and with increased grant levels.

For example, using their respective general equilibrium models, the Ministère des Finances du Québec and the Department of Finance Canada examined the relationship between economic growth and the methods of taxation used.

Previous such analyses suggested that capital taxes were the most damaging to economic growth. A $1.00 reduction in capital tax would result in real GDP growth of $1.29, according to the Department of Finance Canada, and of $1.37, according to the Ministère des Finances du Québec.[43]

These results led the governments of Québec and Canada to abolish their capital tax.

The Ministère des Finances du Québec and the Department of Finance Canada also concluded that consumption taxes are the least damaging and that corporate income tax is more harmful than personal income tax, although their difference is relatively small.

---

[43] Maximilian BAYLOR and Louis BEAUSÉJOUR, *Taxation and Economic Efficiency: Results from a Canadian CGE Model*, Department of Finance Canada Working Paper, November 2004.

■ Results

According to the general equilibrium model for Québec, the most damaging and least damaging taxes for economic growth are as follows.

- — Personal income tax appears much more damaging than consumption taxes (long-term gain from a reduced tax burden of $0.72, compared to $0.43).
- — Once capital tax is eliminated, corporate income tax and payroll taxes have a roughly equal effect on economic growth (long-term gain of a reduced tax burden of $0.60, compared to $0.55).

TABLE 7

Long-term gain in real GDP per $1 decrease in the tax burden
(dollars)

On capital(1)	1.37
On personal income	0.72
On corporate income	0.60
On payroll(2)	0.55
On Québec sales tax	**0.43**
On user fees	0.41

Note: The shock is a tax decrease or grant increase of $1 billion. Simulations were done without effects on government revenues to avoid the effect of expenditure choices. Loss in government revenues is made up for through a flat tax that has a neutral effect on results.
(1) Capital tax was abolished on January 1, 2011. Its impact at the time it was still being levied is presented here for illustrative purposes only.
(2) Impact of a $1 tax decrease applied only to the private sector.
Source: Computable general equilibrium model by the Ministère des Finances du Québec.

The Impact of Methods of Taxation on Economic Growth: A Summary of Canadian and Foreign Studies

S. Acosta-Ormaechea and J. Yoo[1]

Recent work by the IMF shows that for a broad cross-section of countries, a revenue-neutral change in tax composition in which income taxes are lowered and consumption and property taxes are raised would result in faster long-run economic growth. However, the study's results do not suggest that corporate income taxes are more detrimental to growth than personal income taxes.

J. Arnold et al.[2]

Using data from 21 OECD countries from 1971 to 2004, the study ranks taxes from most to least damaging. In order, they are corporate income taxes, personal income taxes, consumption taxes and property taxes.

J. Arnold[3]

This study shows that income taxes are linked to weaker economic growth than either consumption or property taxes. Property taxes are most favourably linked to economic growth, with consumption taxes close behind.

The study also shows a negative correlation between a progressive personal income tax structure and economic growth.

M. Baylor and L. Beauséjour[4]

This study examines the relationship between methods of taxation and economic growth.

Using the Department of Finance Canada's general equilibrium model, the authors conclude that capital taxes are the most damaging to economic growth, followed in order by corporate income taxes, personal income taxes and payroll taxes. Consumption taxes are the least damaging.

R. H. Gordon and Y. Lee[5]

The results of the study show that corporate income tax rates affect economic growth, but only in non-OECD countries.

F. Widmalm[6]

Using data from 23 OECD countries from 1965 to 1990, the study indicates that the proportion of tax revenue raised by taxing personal income has a negative correlation with economic growth. Also, greater tax progressivity is associated with lower economic growth.

---

[1] Santiago Acosta-Ormaechea and Jiae Yoo, "Tax Composition and Growth: A Broad Cross-Country Perspective," IMF Working Paper, 12/257, 2012.

[2] Jens Matthias Arnold et al., "Tax Policy for Economic Recovery and Growth," *The Economic Journal*, Vol. 121, No. 550, 2011, pp. F59–F80.

[3] Jens Matthias Arnold, "Do Tax Structures Affect Aggregate Economic Growth?: Empirical Evidence from a Panel of OECD Countries," OECD Economics Department Working Paper 643, 2008.

[4] Maximilian Baylor and Louis Beauséjour, *Taxation and Economic Efficiency: Results from a Canadian CGE Model*, Department of Finance Canada Working Paper, November 2004.

[5] Roger H. Gordon and Young Lee, "Tax Structure and Economic Growth," *Journal of Public Economics*, Vol. 89, No. 5–6, 2005.

[6] Frida Widmalm, "Tax Structure and Growth: Are Some Taxes Better than Others?," *Public Choice*, Vol. 107, No. 3–4, 2001, pp. 199–219.

The Impact of Methods of Taxation on Economic Growth: A Summary of Canadian and Foreign Studies (continued)

A. Bassanini and S. Scarpetta[7]

This study examines the impact of tax mixes on economic growth for a given level of tax revenues. The authors conclude that higher direct taxation would lead to lower GDP per capita.

B. Fortin, H-P. Rousseau and P. Fortin[8]

This study from 1984 aimed to assess the impact of three personal income tax reform scenarios in Québec.

The authors looked at the economic losses associated with taxes and with the implicit taxation of benefits as well as at the impact of tax changes on production and employment.

The authors concluded that increasing the weight of consumption taxes to offset marginal personal income tax rates would most greatly reduce the economic efficiency losses associated with the tax system and would have the greatest impact on job creation.

Although the results suggest that all categories of individuals would see their income increase, this change in the methods of taxation would lead to greater income inequality. Lastly, the authors stated that tax rates need to be further reduced for highly skilled labourers, since they are the group that experiences the greatest economic loss.

---

[7] Andrea Bassanini and Stefano Scarpetta, "The Driving Forces of Economic Growth: Panel Data Evidence for the OECD Countries," *OECD Economic Studies*, No. 33, 2001.

[8] Bernard Fortin and Henri-Paul Rousseau, with the collaboration of Pierre Fortin, *Évaluation économique des options du Livre blanc sur la fiscalité des particuliers : une approche d'équilibre général* – Report submitted to the Ministère des Finances du Québec, December 1984.

❑ Method assessing the marginal cost of public funds

This section is based on an analysis from the study *Les implications des distorsions fiscales sur la réforme fiscale au Québec,* which was conducted at the Committee's request by Jean-François Wen of the Department of Economics at the University of Calgary, Bev Dahlby of the School of Public Policy at the University of Calgary, and Ergete Ferede of the Department of Economics at MacEwan University.

The study is available in full in Volume 5 of this report (in French only).

The economic cost of taxes paid by the private sector is generally higher than tax revenues collected by the government. This is due to efficiency loss from taxation.

The marginal cost of public funds measures the loss incurred by society when a government collects an additional $1 from a given tax revenue source. In other words, taxes with a higher marginal cost of public funds are those that come at a greater economic cost to society.

When the marginal cost of public funds from one tax revenue source is higher than the marginal cost of public funds from another tax revenue source, a revenue-neutral tax reform that reduces the first revenue source and increases the second can lead to an overall improvement in living standard.

The marginal cost of public funds can be illustrated as follows, which is useful for better understanding the study's results.

In the absence of efficiency losses, when the tax base is unaffected by the variation in tax rate, a simple 10% increase in the tax rate would increase tax revenues by 10%. In this case, the marginal cost of public funds would be equal to 1. In other words, in this case, collecting an additional $1 in tax revenues would cost society $1.

Efficiency losses occur when resources are reallocated to less productive uses. In such cases, the marginal cost of public funds is generally greater than 1.

■ Results of the comparison between provinces

The study compared the marginal cost of public funds in different provinces. The results are presented here.

▪ Personal income taxes

In terms of personal income taxes, the marginal cost of public funds is highest in Québec and lowest in Alberta. The authors state that this is due to Québec's higher personal income tax rates.

- **Corporate income taxes**

The corporate tax base is more volatile than the personal tax base or sales tax base. As a result, the corporate tax base is very sensitive to tax rate changes.

In line with that fact, the study shows that the marginal cost of public funds from provincial corporate income taxes is higher than the marginal cost of public funds from other tax bases.

— The marginal cost of public funds from corporate income taxes varies from $2.35 in New Brunswick to $45.33 in Alberta.

— In Québec, it is $6.88, which is the second highest behind Alberta.

The authors state that the high $45.33 marginal cost in Alberta is due in part to the province's lack of sales tax and the relatively high weight of corporate income taxes in Alberta's tax mix.

The marginal cost of public funds was not calculated for Nova Scotia, Newfoundland and Labrador, Ontario or Saskatchewan, where reducing the corporate income tax rate would increase the present value of tax revenues, as opposed to decreasing it like in the other provinces.

In such cases, the concept of marginal cost of public funds does not apply.

- **Sales taxes**

In terms of sales taxes, the marginal cost of public funds is generally much lower, and this is true across all provinces. The difference between provinces is also much smaller, being $0.42 at most.

Since Alberta has no provincial sales tax, the marginal cost of $1 of public funds is $1. In the provinces with the highest sales tax rates, the marginal cost is approximately $1.40.

TABLE 8

Marginal cost of $1 of public funds
(dollars)

	Marginal cost of public funds		
	Corporate income tax	**Personal income tax**	**Sales tax**
British Columbia	6.38	1.82	1.26
Alberta	45.33	1.44	1.00
Saskatchewan	*	1.86	1.17
Manitoba	2.38	2.15	1.26
Ontario	*	2.71	1.31
Québec	**6.88**	**4.79**	**1.41**
New Brunswick	2.35	1.98	1.31
Nova Scotia	*	2.82	1.42
Prince Edward Island	4.84	2.30	1.42
Newfoundland and Labrador	*	1.69	1.31

* Does not apply.

Source: The authors' calculations are based on the parameter values used in Bev Dahlby and Ergete Ferede's "The Effects of Tax Rate Changes on Tax Bases and the Marginal Cost of Public Funds for Canadian Provincial Governments," *International Tax and Public Finance*, Vol. 19, No. 6, 2012, pp. 844–883.

The Marginal Cost of Public Funds: A Review of Canadian Studies

B. Dahlby and E. Ferede[1]

Using data from Canadian provinces over the period 1972 to 2006, the authors compare the marginal cost of public funds from three methods of taxation in all Canadian provinces. For Québec, the marginal cost of public funds was $2.51 for corporate income taxes, and $1.30 for consumption taxes. For personal income taxes, it was $3.81, the highest in Canada.

B. Fortin and G. Lacroix[2]

In this study, the authors also examine the impact of taxation on tax avoidance and tax evasion. Their results suggest that in Québec, in 1985, the marginal cost of public funds associated with a one percentage point increase in provincial and federal personal income tax rates was between $1.39 and $1.53.

B. Dahlby[3]

This study also examines the marginal cost of public funds from personal income taxes, using different scenarios concerning labour market distortions. The author concludes that the marginal cost of public funds from personal income taxes varies from $1.40 in Alberta to $1.99 in Québec.

W. Thirsk and J. Moore[4]

In this study, the authors evaluate the marginal cost of public funds from personal income taxes using different scenarios concerning labour market distortions. The results suggest that the marginal cost of public funds from personal income taxes is between $1.30 and $1.43.

H. F. Campbell[5]

Campbell was one of the first to attempt to quantify the economic cost of taxation in Canada. He estimated the marginal cost of public funds from taxes on commodities at approximately 1.25.

---

[1] Bev Dahlby and Ergele Ferede, "The Effects of Tax Rate Changes on Tax Bases and the Marginal Cost of Public Funds for Canadian Provincial Governments," *International Tax and Public Finance*, Vol. 19, No. 6, 2012, pp. 844–883.

[2] Bernard Fortin and Guy Lacroix, "Labor Supply, Tax Evasion and the Marginal Cost of Public Funds: An Empirical Investigation," *Journal of Public Economics*, 1994.

[3] Bev Dahlby, "The Distortionary Effect of Rising Taxes," in William B. Robson and William M. Scarth, *Deficit Reduction: What Pain, What Gain?*, C. D. Howe Institute, 1994.

[4] Wayne Thirsk and Jeff Moore, "The Social Cost of Canadian Labour Taxes," *Canadian Tax Journal*, Vol. 39, No. 3, 1991, pp. 554–566.

[5] Harry F. Campbell, "Deadweight Loss and Commodity Taxation in Canada," *Canadian Journal of Economics*, Vol. 8, No. 3, 1975, pp. 441–447.

3. GOVERNMENT INTERVENTION THROUGH TAX EXPENDITURES

There are several definitions for the concept of tax expenditures.

According to the Ministère des Finances du Québec, the concept of tax expenditures "refers to policy choices by which the government agrees to forego some of its tax revenue to achieve its objectives."[44] More specifically, the Ministère des Finances states that tax expenditures are thus exceptions to a standard or a reference that is defined as the basic tax system.

Any measure seeking to confer tax relief that diverges from this basic tax system constitutes a tax expenditure. Accordingly, to establish tax expenditures, the basic tax system must first be defined.[45]

The Ministère states that "fiscal measures can be interpreted in various ways and, depending on the perceptions, opinions can vary as to the elements to include in the basic tax system. . . . [T]here is a subjective component to the exercise."[46]

The Committee prefers to have a broad definition of tax expenditures. For the Committee, "tax expenditures" means all measures set out in tax laws that are designed to relieve taxpayers' tax burden and that as a result reduce the government's tax revenues.

☐ Respective advantages and disadvantages of tax expenditures and budgetary expenditures

The conditions by which assistance is granted is sometimes included in the information normally collected for tax purposes. For example, this is the case with income.

For certain situations, it is easier in terms of administration to offer assistance through tax measures. For example, this is the case with government assistance for childcare expenses.

For other situations, the open budget of tax expenditures may benefit the taxpayer compared to the closed budget of budgetary expenditures.

— When a budgetary program has a limited budgetary envelope, requests made late in the year may not be met with assistance, even though they qualify, because funds have been exhausted. In this case, tax assistance offers taxpayers predictability.

— However, conversely, for the government, budgetary assistance allows for better cost control by defining the envelope available.

---

[44] MINISTÈRE DES FINANCES DU QUÉBEC, *Tax Expenditures* – 2010 edition, February 2011, p. A.3.

[45] Ibid., p. A.4.

[46] Loc. cit.

Some people believe that with budgetary programs, there is greater arbitrariness and influence from political decisions, whereas with tax expenditures, rules are more widely applied.

It is true that in certain situations, things are made easier when taxpayers who meet the eligibility criteria automatically receive the tax expenditure. However, in other situations, there may be advantages to awarding government assistance based on project merit.

■ False advantages

Other people see certain advantages to the use of tax expenditures.

Tax expenditures require less government oversight.

Tax expenditures, except in the case of refundable tax credits, are not recorded in the government budget's public expenditures.

The minister responsible must present his or her budgetary envelope for government adjudication. Tax measures, on the other hand, undergo adjudication less often.

In terms of sound management of public funds, these three arguments are not real advantages and do not justify the use of tax expenditures.

❑ Choosing to use tax expenditures

Professor Jonathan Kesselman has identified numerous areas in which tax expenditures are advantageous in comparison to direct spending programs.[47] He states that for most of the expenditures aimed at societies in general, tax expenditures are more appropriate than budgetary expenditures.[48]

This suggests, therefore, that broad-based taxation is less damaging to market mechanisms than budgetary assistance. However, in the case of regional assistance to companies, Kesselman believes that budgetary expenditures are more appropriate.[49]

In terms of assistance to individuals, in line with the notion of horizontal equity, Kesselman believes tax expenditures are more appropriate. However, he feels that assistance awarded to individuals in the aim of redistributing wealth should be done through budgetary expenditure programs.

---

[47] Jonathan R. KESSELMAN, "Direct Expenditures Versus Tax Expenditures for Economic and Social Policy," *Tax Expenditures and Government Policy: The Seventh John Deutsch Roundtable on Economic Policy*, Queen's University, Ontario, 1988.

[48] Ibid., p. 410.

[49] Ibid., pp. 409–410.

❑ Tax expenditures are growing in number and cost

In each of the main tax bases, the number of tax expenditures is growing.

— For personal income taxes, the number of tax expenditures went from 107 in 1992 to over 160 in 2013.

— For consumption taxes, the number of tax expenditures grew from 43 in 1995 to 48 in 2013.

— For corporate taxes, the number of tax expenditures rose from 45 in 1991 to nearly 90 in 2013.

The cost of tax expenditures is also rising.

— For personal income taxes, the cost of tax expenditures went from $11.3 billion in 2008 to $15.3 billion in 2013.

— For consumption taxes, the cost of tax expenditures went from $3.8 billion in 2008 to $5.4 billion in 2013.

— For corporate taxes, the cost of tax expenditures has remained stable at around $3.2 billion.

TABLE 9

Cost of certain tax expenditures – 2013(1)

(millions of dollars)

Personal taxes	
– Refundable tax credit for child assistance(2)	2,222
– Registered retirement savings plan(3)	2,108
– Registered pension plan(3)	1,771
– Refundable solidarity tax credit	1,721
– Non-taxation of the capital gain on principal residences	1,175
– Partial inclusion of capital gains	739
– Deduction for workers	688
– Medical expense tax credit	674
– Refundable tax credit for childcare expenses	557
– Refundable tax credit attributing a work premium(4)	331
– Refundable tax credit for home-support services for seniors	312
– Charitable donations tax credit	217
– Age tax credit	211
– Tax credit for retirement income	195
– Pension income splitting between spouses	129
– Other	2,288
Subtotal – Personal taxes	**15,338**
Corporate taxes	
– Research and development tax credits	792
– Reduced tax rate for small businesses	578
– Partial inclusion of capital gains	361
– Tax credit for the development of e-business	293
– Investment tax credit for manufacturing and processing equipment	142
– Tax credit for the production of multimedia titles	135
– Tax credit relating to resources	130
– Tax credit for Québec film and television production	125
– Other	675
Subtotal – Corporate taxes	**3,231**
Consumption taxes	
– Zero-rating of basic groceries	1,684
– Exemption of rental accommodation	611
– Exemption in respect of the individual insurance of persons	392
– Zero-rating of prescription drugs	351
– Exemption of health care services	296
– Exemption of financial services	148
– Other	1,874
Subtotal – Consumption taxes	**5,356**
TOTAL	**23,925**

(1) Included in the tax measures announced as at October 31, 2013.

(2) Includes the supplement for children with disabilities.

(3) Includes the deduction of contributions and the non-taxation of investment income, reduced by the taxation of withdrawals.

(4) Includes the work premium adapted to individuals experiencing severe constraints to employment and the supplement for long-term beneficiaries who relinquish last-resort financial assistance or the Alternative jeunesse program.

Source: Ministère des Finances du Québec, *Dépenses fiscales – Édition 2013*, March 2014.

4. ASSESSMENT OF ECONOMIC AND FISCAL IMPACTS

As part of the Committee's work, several organizations presented economic and fiscal impact studies that assess the cost-effectiveness of the tax credits that the government offers to spur different sectors of the Québec economy. Some external studies commissioned by the Committee included or cited these types of impact studies.

Although several of these impact studies addressed the same sectors or industries, the results sometimes varied widely depending on the studies' underlying assumptions.

The results of this examination clearly show the difficulty in assessing the economic impacts of tax credits.

❑ An example

For example, in the assessment of the tax credit for the development of e-business, the cost-effectiveness ratio, expressed as the ratio of tax revenues to the cost of the measure, varies between $1.16 and $1.89.

TABLE 10

Summary of the assessments of the tax impacts for Québec of the tax credit for the development of e-business

(millions of dollars, unless otherwise indicated)

	Direct	Indirect	Induced	Incidental taxation	Total	Cost of assistance	Net impact	Ratio	Ratio without induced effect
TechnoMontréal	n/a	n/a	n/a	n/a	553	293 in 2013	260	$1.89	n/a
Montréal International[1]	125	35	66	199	425	233 in 2010	192	$1.82	$1.54
E&B Data	316	83	—	—	399	288 in 2011	111	$1.39	$1.39
MFQ[2]	268	73	—	—	341	293 in 2013	48	$1.16	$1.16

(1) Impacts assessed on the basis of jobs eligible for the tax credit for the development of e-business excluding corporate income tax.

(2) Impacts assessed on the basis of 21,919 jobs eligible for the tax credit for the development of e-business.

4.1 Statement about method

The Committee wanted to clearly state the general method that had to be used for these types of studies.

It must be pointed out that results are extremely sensitive to the assumptions made when assessing economic and fiscal impacts. Most studies turned to the Institut de la statistique du Québec to assess the impacts of tax credits. The Institut de la statistique du Québec uses an intersectoral model of Québec to perform these assessments, and its role in the assessment process must be acknowledged.

☐ Intersectoral model

To understand the scope of the studies, we need to briefly describe the method that was used.

First, it should be mentioned that the impacts simulated by the intersectoral model cannot be used in place of results from a market analysis, business case or cost-benefit analysis, even if the impact analysis results are a useful complement to those analyses.

In general, the intersectoral model is used to simulate the effects of operating, investment or current consumption expenditures on the economy.

We are concerned with the analysis of economic and fiscal impacts, and the model can be used to simulate the effects on the Québec economy and on government finances of implementing a given tax credit.

The intersectoral model of Québec is the most frequently used tool for calculating the direct and indirect effects of a given economic activity in Québec. The model is a simplified representation of how the Québec economy works. It identifies the interrelations between different sectors or industries of the Québec economy.

The tool is based on assumptions that must be understood to accurately interpret the results.

Direct, indirect and induced effects

Economists define three types of effects of an economic activity: direct, indirect and induced.

Direct effects

Direct effects measure the value added to the economy that can be directly attributed to an industry through wages as well as the remuneration of other factors of production. The concept of added value is clear and is a key element of the economic and fiscal impact assessments.

For example, let us look at the automotive assembly industry. At the start of the production chain, all parts arrive separately to the assembly plant. At the end of the process, the automobiles are ready to be delivered to consumers. Simply put, added value is the value that was created by taking all the parts and assembling them to make automobiles.

Therefore, added value is essentially the difference between the revenue from the sale of the automobile and the cost of each individual part.

Indirect effects

Indirect effects measure the value added to other industries through revenues and wages that suppliers pay to ensure the demand for goods and services is met.

In the automotive assembly example, indirect impacts arise from the added value created, for example, through the production of the electricity needed to assemble the automobiles, or through the production of the automobile parts themselves.

Induced effects

In addition to direct and indirect effects, economists talk about induced effects.

Induced effects arise in particular from expenditures made using the remuneration paid to workers whose remuneration depends directly or indirectly on the activity for which the economic and fiscal impacts are being calculated. The intersectoral model does not account or calculate for induced effects.

The assessment of induced effects requires a detailed understanding of consumer behaviour and the structure of the local economy in which the activities being examined take place. For example, in the case of the expenditures made using the wages paid to workers, the initial amount of the induced impact to be calculated must be accurately determined. Assumptions must be made on workers' savings, or on the transfer revenues received if the worker did not receive the salary paid.

These realities are not accounted for in the intersectoral model and may not even be accounted for in closed models on household consumption that do not consider all possible scenarios. This is why induced effects should not be included in impact analyses.

- **Tax revenues and incidental tax revenues**

It is important to mention that in addition to wages and revenues produced directly and indirectly, the intersectoral model can be used to assess the revenues of the governments of Québec and Canada, in particular in terms of direct wage taxes, sales taxes and specific taxes. These are considered fiscal impacts.

The intersectoral model shows the amounts that go to incidental taxation for the Québec government (Québec Pension Plan, CSST contributions, Health Services Fund, Québec Parental Insurance Plan) and for the federal government (employment insurance).

However, since these programs are generally used to receive benefits, somewhat like an insurance program, the amounts collected through incidental taxation must not be integrated into the fiscal impacts of a project, economic expenditure or tax credit.

❑ Quality of the studies limited by quality of the information submitted

The quality of an economic impact study ultimately depends on the quality of the information submitted to the Institut de la statistique du Québec.

The role of the Institut de la statistique du Québec is to employ the intersectoral model using assessment data concerning the effects of tax credits on the Québec economy, as calculated by the organization requesting the assessment.

■ Case of tax credits

The benefit-cost ratio is a ratio of economic and fiscal cost-effectiveness.

When analyzing a tax credit, a fiscal cost-effectiveness ratio greater than 1 means that the tax revenues the tax credit produces are greater than the costs of the tax credit for the government.

Similarly, a fiscal cost-effectiveness ratio less than 1 means that the tax revenues the tax credit produces are less than the costs of the tax credit for the government.

■ Difficulties

One of the challenges of conducting a study on the economic impacts of a tax credit is determining how many jobs would be created or how many investments would be made in the presence and in the absence of a tax credit. When implementing a tax credit to boost job creation in a given sector or industry, the industry's behaviour in terms of that implementation must be understood. Statistical analyses or company surveys would make it possible to isolate a tax credit's effect.

Another major challenge of conducting economic and fiscal impact studies is assessing the immediate effects of a stimulus on the Québec economy.

Opportunity cost of workers

Certain assumptions need to be specified at the start.

For example, if a sector hires more workers once a tax credit is implemented, it is important to determine the opportunity cost of those workers to assess the real economic and fiscal impacts on the economy of those new jobs in the sector.

Opportunity cost can be illustrated as follows: if the worker was unemployed, it is a net gain for the economy because the worker's opportunity cost is zero.

- However, if that person worked for another employer, the opportunity cost is not zero. If the worker earns $75,000 in the job created by the tax credit and earned $50,000 (the alternative salary) in his or her previous job, the gain for the worker and for the Québec economy is $25,000.
- If, on the other hand, the vacated position is now occupied by someone who was unemployed, the net gain for society is $75,000.

Therefore, the higher the unemployment rate or the greater the availability of workers in a sector, the lower the opportunity cost and the greater the gains.

Conversely, low unemployment rates and low availability of workers in a sector or industry likely mean very high opportunity costs.

Even if an analysis of the real economic and fiscal impacts of a tax credit shows that the benefits are greater than the costs, this does not automatically mean that the net marginal benefit of increasing a tax credit will be positive.

For example, if there is currently a labour shortage in the sector, the marginal benefits of increasing a tax credit may be very low because the opportunity cost of the labour force will be very high, and this could greatly attenuate the marginal benefits.

Obviously, depending on the assumptions made at the start concerning certain parameters, the economic and fiscal impacts calculated can be very different.

Interpretation of results

It is very important that these elements be considered before making any conclusions about economic and fiscal impacts.

To measure the effect of considering the opportunity cost of workers in the economic impact studies, the following three methods were applied to assess a hypothetical shock on the economy of a new recurrent operating expenditure of $20 million per year in the software publishing sector.

Classic method

The opportunity cost of workers is not considered.

Alternative salary method

This method assumes that the employees in the new jobs came from other jobs and that the vacated positions have not been filled. In this example, it is assumed that in their previous jobs, the workers earned on average 50% of the wages they now earn in their new jobs.

Labour market rebalancing method

This method assumes that the positions vacated by the creation of new jobs have not all been filled immediately.

For example, the creation of 100 new jobs allows 25 people who were unemployed, newly graduated or newly immigrated to find a job. The 75 other jobs are filled by workers who have changed jobs, thereby freeing 75 other jobs that are not filled immediately. This type of situation creates successive labour shortages in the short term until the labour market regains equilibrium.

- **Economic impacts**

Ultimately, the three methods make it possible to assess that the project can support 100 direct jobs with an average salary of close to $72,000. In addition, project activities can create or maintain 53 indirect jobs among the industry's suppliers.

- **Fiscal impacts**

The sensitivity analysis shows that opportunity cost plays an important role in the assessment of fiscal impacts.

The alternative salary method results in a fiscal impact that is 20.5% lower than that arrived at through the classic method. This less intuitive method does not take into account the transition effects on the labour market.

The labour market rebalancing method results in a fiscal impact that is 9.1% lower than that arrived at through the classic method. This approach, which reproduces the dynamics of the labour market, provides more realistic results over the long term. In addition, the annual fiscal impacts are lower at the start of the period than at the end.

TABLE 11

Fiscal impacts calculated using three methods, new recurrent operating expenditure of $20 million per year in the software publishing sector, 10-year total
(millions of dollars, unless otherwise indicated)

	Classic	Alternative salary	Labour market rebalancing
Direct fiscal impacts	16.5	12.5	14.7
Indirect fiscal impacts	5.4	4.9	5.2
TOTAL	**21.9**	**17.4**	**19.9**
Difference compared to classic scenario		−20.5 %	−9.1 %
Cost of assistance(1)	17.3	17.3	17.3
Fiscal cost-effectiveness ratio	1.27	1.01	1.15

(1) The cost of assistance associated with this activity, the tax credit for the development of e-business, is estimated at $1.7 million per year.

TABLE 12

Tax assistance for businesses – Summary of fiscal impact assessment studies(1)

Tax assistance	Author	Impacts	Benefit-cost ratio	Scope of analysis
R&D	TechnoMontréal	Direct, indirect and induced	2.22	ICT sector
	Écotech Québec	Direct and induced	1.55	Clean technologies sector
E-business development	E&B Data	Direct and indirect	1.39	Eligible jobs
	Montréal International	Direct, indirect, induced and incidental tax	1.82	Eligible jobs
	TechnoMontréal	Direct, indirect, induced and incidental tax	1.89	Eligible jobs
	Ministère des Finances	Direct and indirect	1.16	Eligible jobs
Multimedia titles	KPMG	Direct, indirect and induced (partial)	1.07	Jobs – Video game sector
	E&B Data	Direct and indirect	1.41	Jobs – Video game sector
	Ministère des Finances	Direct and indirect	1.01	Eligible jobs
Film and television production	AQPM(2)	Direct, indirect and incidental tax	0.58	Eligible jobs
	Technicolor	Direct, indirect and incidental tax	1.90	Technicolor – Post-production activities
Film production services	PwC(2)	Direct, indirect and induced	0.61	Visual and special effects contracts
	Technicolor	Direct, indirect and incidental tax	0.54	Technicolor – Visual effects
	Ministère des Finances	Direct and indirect	0.36	Filming activities
Sound recordings and production of shows	ADISQ(2)	Direct, indirect and incidental tax	2.84(3)	Total operating expenditures
Film dubbing	ANDP(2)	Direct and induced (partial)	1.65	Eligible jobs
	Technicolor	Direct, indirect and incidental tax	2.75	Technicolor – film dubbing activities
International financial centres	KPMG	Direct (personal taxes only), indirect and induced	0.58	Eligible jobs
Tax-advantaged funds	IRÉC(2)	Direct, indirect, induced and incidental tax	1.77	Fondaction(4)
	KPMG – Regional Data	Direct, indirect, induced and incidental tax	2.50	Fonds de solidarité FTQ(5)
	EcoTec Consultants	Direct, indirect and induced	1.60	CRCD(6)

(1) The studies conducted do not consider the 20% reduction in the tax credit rates announced in the 2014-2015 budget

(2) Association Nationale des Doubleurs Professionnels (ANDP), Association québécoise de l'industrie du disque, du spectacle et de la vidéo (ADISQ), Association québécoise de la production médiatique (AQPM), Bureau du cinéma et de la télévision du Québec (BCTQ), Institut de recherche en économie contemporaine (IRÉC) and PricewaterhouseCoopers (PwC).

(3) The ratio was determined using the fiscal impacts and the total amount of assistance from the Québec government (fiscal and budgetary) as calculated by the organization.

(4) Report presented in 2014 for the Fund's activities in 2013-2014.

(5) Report presented in 2010 for the Fund's activities in 2009.

(6) Report presented in 2011 for the Fund's activities in 2010.

5. EFFECTS OF TAX COMPETITION

Jurisdictions can compete with one another tax-wise. To do so, they can reduce their tax base or their tax rate.

5.1 Tax competition sometimes justified, sometimes harmful

The main goal of tax competition is to attract to a jurisdiction assets, activities or compensation associated with risk taking, which are all sources of added value.

☐ Question of costs and benefits

For jurisdictions involved in tax competition, a benefit-cost analysis is required: the action has public and private costs as well as public and private benefits.

Tax competition is justified for a jurisdiction when the sum of the public and private costs is lower than the sum of the public and private benefits.

■ Positive effects of tax competition

In terms of sovereignty of jurisdictions and diversity of preferences, there are three positive aspects to tax competition. Tax competition makes it possible to:

- Adapt government action to people's preferences
- Encourage jurisdictions to achieve the greatest efficiency possible, so as not to lose the sources of added value (assets, activities and risks) within their respective jurisdictions
- Develop a comparative advantage that did not previously exist and increase a sector's productivity in a way that makes tax relief no longer necessary

■ Negative effects of tax competition

There is one negative aspect to tax competition.

Jurisdictions react to one another. When one jurisdiction adopts a strategy that reduces its tax base or its tax rate, other jurisdictions are compelled to offer a greater reduction. In this attempt to outdo each other, jurisdictions can reduce their tax revenues considerably, which means greatly reduced pubic spending and transfers.

Some describe this effect of competition as "levelling down," which is an overall losing strategy for all jurisdictions.

☐ "Harmful tax competition" – an OECD perspective

In addition to possibly insufficient public spending and transfers, there is another issue related to tax competition that is called "harmful tax competition." This occurs when jurisdictions abide by an impenetrable code of silence that inadvertently encourages tax evasion. Harmful tax competition has led the OECD to promote information exchange agreements between certain countries, some of which are known as "tax havens."

5.2 The case of Québec

Québec has implemented a number of tax measures designed to encourage the development of certain areas of activity.

Some measures have been very successful at attracting several major businesses to cutting-edge fields, which are known for offering very good wages in prestigious sectors.

Québec's measures are admired and envied by other jurisdictions. This is true, for example, of the multimedia title production field.

☐ Response of other jurisdictions and risks of companies moving

Other jurisdictions have responded by offering tax measures that are as attractive, if not more so. With this, the tax competition in cutting-edge fields is evident.

Because of this competition, Québec finds itself in a situation in which it must now, in an effort to keep businesses within the province, award several companies tax credits on a practically permanent basis that are greater than the tax revenues those companies generate.

In this current situation, any reduction of the benefits conferred raises the risk, real or perceived, of those companies closing or moving, which would come with associated job losses.

5.3 Assessment of consequences

Companies' ability to move in a way that is advantageous to them depends critically on the existence of similar or greater benefits in jurisdictions elsewhere in Canada or the world.

Jurisdictions may award tax advantages to account for externalities, economies of scale or other specific situations.

However, tax advantages whose sole objective is to attract assets, activities and risks from abroad are part of the problem with tax competition.

The only effect of such tax advantages is skewed relative prices and an inefficient allocation of resources internationally. In such cases, all jurisdictions involved in the tax competition are collectively squandering their public funds.

☐ International reflections

More and more countries are concerned with the negative effects of international tax competition, and international studies and meetings on the subject have multiplied.

The tax expert Brigitte Alepin was in attendance at a private conference in London called The Impact of Globalisation on Taxation. Through her, the Committee has an overview of current reflection and thought on tax competition.

Her summary of the event's presentations and discussions are available in Volume 5 of this report (in French only).

PART 5:
THE MAIN CHARACTERISTICS OF PERSONAL INCOME TAX

The fifth topic addressed by the Committee was the main characteristics of personal income tax.

This section examines:

- The personal income tax burden
- The breakdown of taxpayers by income group
- The top marginal tax rate
- Non-taxable taxpayers
- The change in disposable income
- The use of tax assistance for retirement savings
- The preferential tax treatment of capital gains
- The problem of implicit marginal taxation rates

1. THE PERSONAL INCOME TAX BURDEN

Québec is one of the places with the highest personal income tax burden as a percentage of GDP.

Federal and Québec personal income tax represents 13.0% of GDP.

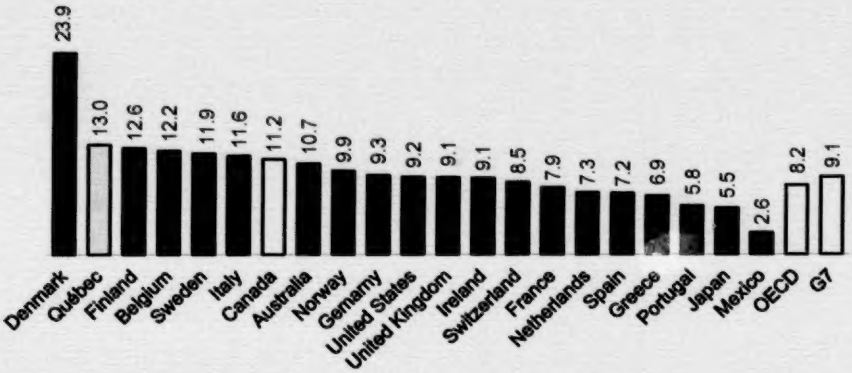
❑ Considerable difference compared to OECD countries

The difference is considerable compared to the average burden in OECD countries. Québec is even ahead of three Scandinavian countries—Finland, Sweden and Norway.

However, Québec is behind Denmark, where personal income tax represents 23.9% of GDP.

CHART 8

The weight of personal income tax – 2012
(as a percentage of GDP)



Sources: OECD, data warehouse as at January 30, 2015, and Institut de la statistique du Québec, *Comptes économiques des revenus et dépenses du Québec* (2014 edition).

2. THE BREAKDOWN OF TAXPAYERS BY INCOME GROUP

In 2011, Québec had 6.4 million personal income taxpayers.

- A total of 309,649 taxpayers (4.8%) had total income of $100,000 or more. These taxpayers paid 35.9% of all taxes.
- A total of 112,475 taxpayers had income of $150,000 or more. These taxpayers represented 1.7% of all taxpayers but paid 22.4% of the taxes collected in Québec.
- A total of 41,408 taxpayers (0.6%) had income of $250,000 or more in 2011. They contributed 14.0% of taxes paid.
- A total of 2,815 taxpayers had income of $1,000,000 or more. These taxpayers represented less than 0.1% of all taxpayers and contributed 3.8% of all taxes.

TABLE 13

Breakdown of taxpayers by total income group – 2011

	All taxpayers		Taxable taxpayers		
	Number	As a %	Tax payable (millions of $)	As a %	Average tax ($)
Less than $50,000	4,860,711	75.5	5,535	23.4	2,198
$50,000 to $100,000	1,269,699	19.7	9,604	40.6	7,627
$100,000 to $150,000	197,374	3.1	3,219	13.6	35,446
$150,000 to $200,000	49,525	0.8	1,248	5.3	25,540
$200,000 to $250,000	21,342	0.3	730	3.1	34,633
$250,000 to $500,000	30,195	0.5	1,590	6.7	53,198
$500,000 to $1,000,000	8,398	0.1	810	3.4	97,146
$1,000,000 or more	2,815	0.0	907	3.8	324,878
TOTAL	**6,440,059**	**100.0**	**23,642**	**100.0**	**5,789**

Sources: Revenu Québec and Ministère des Finances du Québec.

3. THE TOP MARGINAL TAX RATE

In Québec, the top marginal tax rate is 50%, including federal tax.

❑ An international comparison

The average top marginal rate of OECD countries was 43.3% in 2013. Québec is above the average of OECD countries with a rate of 50%.

Among the 34 OECD countries, the top marginal rate varies between 15% in the Czech Republic and 56.7% in Sweden.

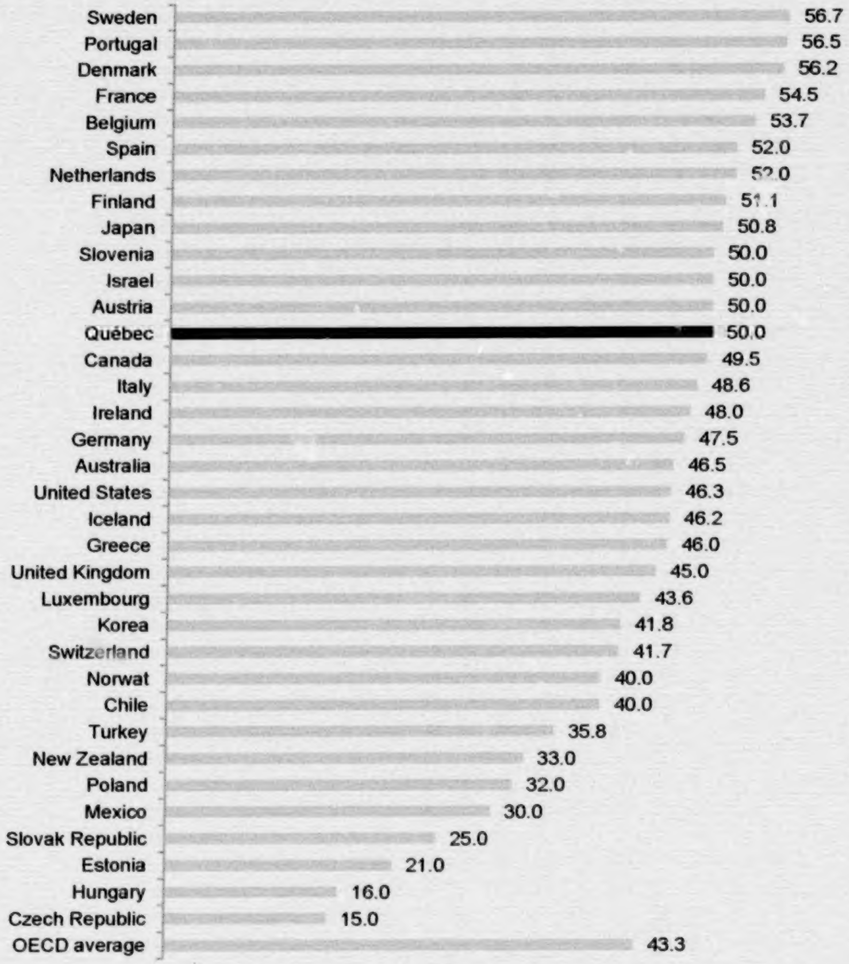
Only nine countries have a rate greater than 50%.

Between 2000 and 2013, the average top marginal rate of OECD countries dropped 3.3 percentage points, from 46.5% to 43.3%.

During the same period, the top marginal rate in Québec decreased from 50.7% to 50.0%.

CHART 9

Top marginal tax rates in OECD countries – 2013



Sources: OECD and Ministère des Finances du Québec.

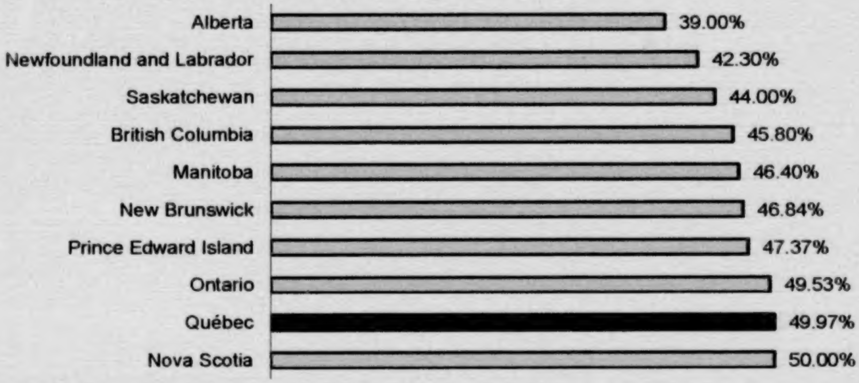
☐ An interprovincial comparison

Québec ranks second among the Canadian provinces from the standpoint of combined top marginal tax rate. High-income taxpayers in Québec are taxed at a marginal tax rate comparable to the one in Ontario (49.53%).

However, the top rate is reached on an income of roughly $136,000 in Québec, as compared to $220,000 in Ontario.

CHART 10

Combined (federal and provincial) top marginal tax rate by province – 2014



Source: Ministère des Finances du Québec.

4. NON-TAXABLE TAXPAYERS

In 2011, nearly 37% of taxpayers were non-taxable, meaning they did not pay taxes. Non-taxable taxpayer rates have been relatively stable for a few years.

TABLE 14

Non-taxable taxpayer rates – 1995 to 2011
(number in thousands, change in percentage)

	Non-taxable taxpayers[1]		All taxpayers		Rate of non-taxable taxpayers (as a %)
	Number	Change	Number	Change	
1995	1,829	1.5	4,848	1.7	37.7
1998	2,240	7.7	5,424	3.0	41.3
2001	2,263	4.7	5,664	1.3	40.0
2004	2,425	1.2	5,874	0.9	41.3
2007	2,158	-2.7	6,058	1.2	35.6
2008	2,215	2.7	6,122	1.0	36.2
2009	2,276	2.7	6,179	0.9	36.8
2010	2,345	3.0	6,307	2.1	37.2
2011	2,333	-0.5	6,372	1.0	36.6

(1) Based on the most recent information from Revenu Québec, excluding child assistance.
Sources: Ministère des Finances et de l'Économie and Revenu Québec, *Statistiques fiscales des particuliers – Année d'imposition 2011*, March 2014, p. 39, Table 25.

☐ Other tax expenses payable

It should be noted that non-taxable taxpayers pay other taxes such as QST, property taxes and certain contributions such as Québec Parental Insurance Plan contributions.

☐ Portrait of non-taxable taxpayers

Non-taxable taxpayers include:

- Individuals who do not earn any income from remunerated work
- Recipients of government benefits, including beneficiaries of last resort assistance and seniors receiving federal guaranteed income supplement benefits
- Individuals earning low income from remunerated work
- Young students, including those who have a part-time or summer job

Over 80% of taxpayers under 20 years of age were not taxable in 2011.

■ Filing of income tax returns

Certain taxpayers file income tax returns even if their income is too low to have to pay taxes in order to recover payroll deductions that were withheld on their salary or to benefit from certain refundable tax credits such as the solidarity tax credit. This is particularly the case for students.

Canada Revenue Agency data indicates that the proportion of taxpayers that file a tax return can vary by province.

- In Québec, 95.2% of taxpayers aged 20 to 64 years filed a tax return in 2011.
- In the rest of Canada, this proportion was only 86.5%.

☐ A comparison

When we compare Québec and the rest of Canada in terms of the percentage of people aged 20 to 64 years who do not pay income tax, two conclusions come to light depending on whether or not we restrict the analysis to only those individuals who filed a tax return.

- In 2011, 29.2%of individuals aged 20 to 64 years who filed a tax return in Québec did not pay taxes. In the other provinces, this percentage was lower (27.1%).
- On the other hand, 32.6% of all individuals aged 20 to 64 years did not pay taxes, whereas this percentage was 36.9% in the other provinces.

5. THE CHANGE IN DISPOSABLE INCOME

From 1981 to 2010, the average real disposable income and median real disposable income of older individuals increased more rapidly than those of the other age groups of the population.

- For both average and median income, seniors aged 65 years and over saw the strongest increase.
- The median real disposable income of seniors aged 75 years and over rose from $12,000 in 1981 to $19,500 in 2010.

Thus, the income gap between seniors and young people decreased considerably during that time. In 1981, the average income of an individual aged 75 years and over represented 60.4% of the income of an individual aged 25 to 34 years. In 2010, this proportion was 76.8%.

TABLE 15

Growth in disposable income since 1981 by age in Québec, in constant 2010 dollars
(as a percentage)

Age	Average disposable income	Median disposable income
75 years and over	53	63
65 to 74 years	43	51
55 to 64 years	24	43
45 to 54 years	34	26
35 to 44 years	24	14
25 to 34 years	20	17

Source: Institut de la statistique du Québec, *Revenu, faible revenu et inégalité de revenu : portrait des Québécoises et des Québécois de 55 ans et plus vivant en logement privé*, July 2013.

Private pension plans were in large part responsible for the growth in income of seniors aged 65 years and over during that period. The average income from private pension plans increased from $2,500 in 1980 to $9,500 in 2010 for individuals aged 65 to 74 years.

In 1966, the Québec Pension Plan was established for all workers, and in 1970, the RRSP became available to everyone.

A significant portion of the increase in income of individuals aged 65 years and over resulted from the maturation of these plans.

6. THE USE OF TAX ASSISTANCE FOR RETIREMENT SAVINGS

The federal and Québec taxation systems include many measures aimed at encouraging people to save money.

☐ Arguments against enhancing the system

In a study entitled *Québec Income Taxation and Incentives for Household Savings*[50] conducted at the request of the Committee, author Jonathan Rhys Kesselman puts forward three main arguments against substantially enhancing tax assistance to encourage savings.

- Tax incentives are reportedly rather ineffective at significantly increasing most individuals' savings levels.
- Losses in tax revenues resulting from savings incentives are already considerable.
- The preferential tax treatment of savings often benefits those at the highest income levels.

The study is available in full in Volume 5 of this report (in French only).

This stance supports the conclusion of the Expert Committee on the Future of the Québec Retirement System chaired by Alban D'Amours. The committee wrote in its report:

> The Committee believes the current tax measures concerning retirement should not be enhanced. In general, the tax system already has sufficient measures to encourage individuals to save for retirement. The Committee does not believe that new tax incentives are necessary to boost retirement coverage.[51]

☐ Registered retirement savings plans and registered pension plans

Among the abundance of measures to encourage savings, the preferential tax treatment of contributions to registered pension plans (RPPs) and registered retirement savings plans (RRSPs) is certainly the most considerable tax measure.

- RPPs are arrangements established by a private or public employer to provide retirement pensions to its employees.
- RRSPs are individual pension plans. In this case, contributions are made to it with the intent of having them grow to accumulate savings until retirement.

---

[50] Jonathan Rhys Kesselman, *Québec Income Taxation and Incentives for Household Savings*, November 17, 2014.

[51] Expert Committee on the Future of the Québec Retirement System, *Report—Innovating for a Sustainable Retirement System*, Gouvernement du Québec, April 2013, p. 114.

Tax assistance pertaining to RPPs and RRSPs has three components:

- The deductibility of contributions made to such plans
- The non-taxation of investment income accumulated in the plans
- The taxation of withdrawals from RRSPs and benefits received from RPPs

■ RRSPs

An individual can deduct all the contributions they made to RRSPs during a given year and the 60 days following the end of the year, up to the RRSP ceiling for the year. This maximum amount eligible for deduction corresponds to 18% of income earned during the preceding year, up to the ceiling of $24,930 set for 2015. This amount is indexed annually.

■ RPPs

In the case of RPPs, the ceilings differ depending on whether the plans are defined contribution plans or defined benefit plans.

- The amount employers and employees are able to deduct for defined contribution plans is set at $25,370 for 2015. This amount is indexed annually.
- In the case of defined benefit RPPs, it's the maximum amount of benefits that is limited. The amount that an employee can contribute to a defined benefit plan is not subject to a ceiling.

The employer's contributions are limited to the amount necessary to ensure full funding of anticipated benefits.

☐ Among the most considerable tax expenditures

Tax expenditures to encourage retirement savings are among the most considerable tax expenditures.

- The cost of the Québec government's tax expenditure pertaining to RRSPs was estimated to be $2.1 billion in 2013. This amount takes into account the value of the deductibility of contributions, the non-taxation of investment income and the taxation of withdrawals.
- In terms of contributions to RPPs, the cost of the Québec government's tax expenditure was $1.8 billion in 2013. This amount includes the same three components.

These two measures combined represented more than 25% of the cost of personal income tax expenditures.

Of the approximately 6.4 million returns filed in Québec in 2011, taxpayers claimed deductions for RPP contributions in nearly 1.5 million of them and deductions for RRSP contributions in nearly 1.6 million of them.[52]

---

[52] MINISTÈRE DES FINANCES ET DE L'ÉCONOMIE AND REVENU QUÉBEC, *Statistiques fiscales des particuliers – Année d'imposition 2011*, March 2014.

☐ The beneficiaries of these measures

In a study conducted by the Research Chair in Taxation and Public Finance at the University of Sherbrooke at the request of the Committee,[53] the author examines the extent to which different groups of taxpayers benefit from various tax measures, including measures to encourage retirement savings.

The study is available in full in Volume 5 of this report (in French only).

The author proposes an index in order to compare the breakdown of the shortfall attributable to the tax advantage granted to different groups of taxpayers, categorized by income, to the breakdown of taxes paid by these same groups of taxpayers.

- An index equal to 1 means that the portion of the government's shortfall that is attributable to the tax advantage granted to the group of taxpayers is proportional to the portion of taxes paid by the taxpayers in that income group.
- The smaller the index value, the less beneficial the tax measure is to the group of taxpayers in question based on the amount of tax they pay.

■ The findings of the study

Taxpayers in the $40,000 to $69,999 income group contribute the most in millions of dollars to the government's shortfall pertaining to RPP and RRSP deductions as well as the combination of these deductions.

This is in part due to the fact that this group of taxpayers represents a large portion of all taxpayers independent of their use of the tax measures.

If we take an individual approach, an analysis using the index described above reveals that taxpayers in the $150,000 to $249,999 income group would benefit more from the RRSP contribution measure but less from the RPP contribution measure.

TABLE 16

Shortfall and shortfall index based on taxes payable on retirement plan contributions – 2011

	RPP			RRSP			RPP and RRSP		
	Shortfall			Shortfall			Shortfall		
	$M	%	Index	$M	%	Index	$M	%	Index
$1 to $19,999	11.3	0.6	**1.1**	12.4	0.8	**1.4**	23.7	0.7	1.2
$20,000 to $39,999	141.4	7.4	**0.6**	124.4	8.1	**0.7**	265.8	7.7	0.6
$40,000 to $69,999	721.8	38.0	**1.2**	443.4	28.9	**0.9**	1,165.3	33.9	1.1
$70,000 to $99,999	587.9	30.9	**1.5**	330.8	21.5	**1.1**	918.7	26.7	1.3
$100,000 to $149,999	318.7	16.8	**1.2**	308.2	20.1	**1.5**	626.9	18.2	1.3
$150,000 to $249,999	89.4	4.7	**0.6**	181.1	11.8	**1.4**	270.5	7.9	0.9
$250,000 or more	30.3	1.6	**0.1**	135.5	8.8	**0.6**	165.8	4.8	0.3

Source: Suzie St-Cerny, *Impôts sur le revenu des particuliers au Québec : Qui profite le plus des déductions et des crédits?*, University of Sherbrooke, Research Chair in Taxation and Public Finance, October 2014.

---

[53] Suzie ST-CERNY, *Impôts sur le revenu des particuliers au Québec : Qui profite le plus des déductions et des crédits?*, University of Sherbrooke, Research Chair in Taxation and Public Finance, October 2014.

When we consider the RPP and RRSP measures together, the only groups of taxpayers who benefit less than they contribute in taxes—who have an index value of less than 1—are taxpayers whose income is between $20,000 and $39,999 or is $150,000 or over.

In other words, the analysis of the two forms of tax assistance for retirement savings considered together reveals index values greater than 1 for all taxpayers whose income is between $40,000 and $149,999.

Seeing as these two measures are somewhat complementary, it is relevant to analyze them together to avoid premature conclusions regarding the benefits claimed by taxpayer groups for either plan. The tax treatment granted to taxpayers who contribute to RRSPs is intended to put workers who do not have an employer-sponsored pension plan on equal footing with those who do.

This symmetry is necessary. Any lowering of the ceiling for deductible RRSP contributions should be accompanied by an equivalent lowering of the ceilings for RPP contributions and benefits.

7. THE PREFERENTIAL TAX TREATMENT OF CAPITAL GAINS

In the Québec and federal tax systems, capital gains are subject to specific tax treatment.

7.1 Background on capital gains taxation

Historically, the rules for capital gains taxation have varied considerably.

The Royal Commission on Taxation created in 1962 recommended taxing capital gains in order to improve horizontal and vertical equity. It suggested taxing all capital gains at the time of disposing of the asset in order to avoid certain liquidity problems. It proposed not to include an adjustment for inflation for fair treatment mainly with interest and dividend income.

In 1969, the Canadian Minister of Finance recommended to tax capital gains but to include only half of the gain, the main reason being to reduce the opposition created by the imposition of taxes on this income.

■ Changes over the years

Over the years, several changes have been made to the capital gains inclusion rate.

- Beginning January 1, 1972, capital gains became taxable at a rate of 50%.
- In 1988 and 1989, the capital gains inclusion rate rose to 66.67%.
- In 1990, the capital gains inclusion rate climbed to 75%.
- In 2000, the capital gains inclusion rate dropped to 66.67% after February 27 and before October 18.
- Since October 18, 2000, the capital gains inclusion rate has remained 50%.

When these changes were made, the Québec government always harmonized its capital gains inclusion rate with that of the federal government, as did all the other provinces.

7.2 Analysis of the concentration of capital gains

The following data from the study *La fiscalité québécoise et l'utilisation des mesures fiscales destinées aux particuliers* conducted at the request of the Committee by Suzie St-Cerny, Research Chair in Taxation and Public Finance, leads to certain conclusions.

The study is available in full in Volume 5 of this report (in French only).

One of the commonly expressed criticisms about the partial inclusion of capital gains is that this tax measure essentially benefits taxpayers with the highest incomes.

☐ Some observations about capital gains

By analyzing the income group of taxpayers who declare capital gains, we observe the following:

- In 2011, just under 50% of capital gains were realized by taxpayers declaring over $250,000 in income.

- Inversely, taxpayers declaring less than $40,000 in income realized only 5% of capital gains.

■ Data to be interpreted cautiously

However, caution must be exercised when interpreting these statistics because the capital gain itself constitutes income. Thus, a taxpayer who realizes a one-time or non-recurring capital gain, for example by selling a business or an income property, may be relocated to a higher income group in the year in which they realize the gain, without the same necessarily being the case in subsequent years.

Take, for example, a farming family that has always declared annual family income of between $30,000 and $80,000. The year the family disposes of the farm property, each partner might realize capital gains of $800,000.

In the statistics, two taxpayers declaring income over $250,000 will realize capital gains, but they are not actual high-income taxpayers on a regular basis.

■ To illustrate

To illustrate this fact, we used data from Statistics Canada to analyze capital gains information declared by Québec taxpayers and to classify the capital gains by income group with income levels including and excluding capital gains.

A large proportion of capital gains are realized by taxpayers who would not be classified in the high-income taxpayer groups without the gains.

— Thus, the total value of capital gains realized by taxpayers earning less than $50,000 jumped from $281 million to $1.099 billion.

— The total value of capital gains realized by taxpayers declaring more than $250,000 in income fell from $1.458 billion to $624 million.

TABLE 17

Taxable capital gains by income group, Québec – 2012

	Categorized by income group including capital gains		Categorized by income group excluding capital gains	
	Taxable capital gains	Number of filers	Taxable capital gains	Number of filers
Under $50,000	$281,340K	187,570	$1,099,260K	202,290
$50,000 to $100,000	$530,095K	129,030	$690,280K	124,070
$100,000 to $200,000	$619,640K	51,490	$523,290K	45,900
$200,000 to $250,000	$189,205K	6,980	$141,885K	5,940
$250,000 or more	$1,458,060K	16,080	$623,630K	12,950
TOTAL	**$3,078,345K**	**391,150**	**$3,078,345K**	**391,150**

Source: Statistics Canada, special tabulation, from capital gains in Canada, 2014.

7.3 Lifetime capital gains exemption

The lifetime capital gains exemption was introduced in 1985 notably to stimulate investments and thereby increase risk taking by Canadian corporations, mainly encouraging equity financing.

The lifetime capital gains exemption also aimed to enable farmers and small business owners to accumulate a certain amount of retirement capital.

☐ Background of the lifetime capital gains exemption

The application of this exemption has changed over time.

- In 1985, the exemption was intended to be phased in over five years for the disposition of property in general, to reach $500,000 in 1990. Farm property was eligible for the full maximum exemption amount right from 1985.
- In 1987, the federal government reduced the lifetime capital gains exemption to $100,000 for most property but retained the $500,000 exemption for gains on qualified small business corporation shares and qualified farm property.
- In 1994, the $100,000 lifetime capital gains exemption applicable to the disposition of property in general was repealed, with a transitional rule authorizing the increase of the fiscal cost of eligible property.
- The $500,000 exemption for qualified small business corporation shares and qualified farm property remained in effect.
- The lifetime capital gains exemption has been available since 2006 for capital gains on qualified fishing property.
- In 2007, the $500,000 amount was increased to $750,000 with eligible property remaining qualified small business corporation shares and qualified farm and fishing property.
- Since January 1, 2014, the maximum amount has been $800,000. This amount will be indexed for years after 2014.
- The Québec government has always harmonized its maximum lifetime capital gains exemption amount and types of eligible property with those of the federal government, as have the governments of the other provinces.
- Since January 1, 2015, however, the Québec government has set itself apart by increasing to $1,000,000 only the lifetime capital gains exemption for farm and fishing property.

❑ Analysis of the impact of the capital gains exemption

In 1994, a symposium was held to analyze the relevance of the lifetime capital gains exemption.

According to Mintz and Richardson's[54] summary of the symposium, the lifetime capital gains exemption is not an efficient method to stimulate investment and risk taking.

Initially, the exemption was supposed to increase the financing available to corporations to help with capital investments. However, corporations were not able to significantly benefit from more advantageous financing conditions.

According to Mintz and Richardson, there is no convincing proof that the lifetime capital gains exemption has had a significant impact on the indebtedness of corporations or increased the equity portfolio of investors.

According to certain authors,[55] the lifetime capital gains exemption enabled farmers to create retirement capital they would not have been able to build with an RRSP. However, the case was different for owners of SMEs, who would instead have been able to use their RRSP to accumulate retirement funds.

---

[54] Jack M. MINTZ and Stephen R. RICHARDSON, "The Lifetime Capital Gains Exemption: An Evaluation", *Canadian Public Policy*, Vol. 21, No. s1, 1995, pp. 13–26.

[55] Ibid. The authors cited are Jog and Schaller.

7.4 Tax expenditures associated with the preferential tax treatment of capital gains

The preferential tax treatment of capital gains represents a significant amount. This represented total tax expenditures of nearly $2.5 billion for the Québec government in 2013. Federal expenditures for the same year were close to $14 billion for the entire country.

- By itself, the partial inclusion of capital gains—for individuals as well as corporations—represented a tax expenditure of $1.1 billion for the Québec government in 2013. The federal tax expenditure for the same partial inclusion was just over $8 billion for the entire country.
- That same year, the lifetime capital gains exemption represented a tax expenditure of $156 million for Québec and just over $1 billion for the federal government for the entire country.
- The non-taxation of the capital gain on principal residences is also a significant tax expenditure for governments. In 2013, the tax expenditure was close to $1.2 billion for the Québec government and just over $4 billion for the federal government for the entire country.
- As for the tax treatment of stock options offered to employees, which are treated similarly to capital gains, it represented a tax expenditure of $45 million for the Québec government and $720 million for the federal government for the entire country in 2013.

TABLE 18

Tax expenditures associated with the preferential tax treatment of capital gains – 2013
(in millions of dollars)

	Federal	Québec
Partial inclusion of capital gains of individuals	3,945	739
Partial inclusion of capital gains of corporations	4,085	361
Lifetime capital gains exemption for small business corporation shares and farm and fishing property	1,090	156
Non-taxation of the capital gain on principal residences	4,005	1,175
Stock options	720	45
TOTAL	**13,845**	**2,476**

Sources: Ministère des Finances du Québec, *Dépenses fiscales – Édition 2013*, March 2014, and Department of Finance Canada.

8. THE PROBLEM OF IMPLICIT MARGINAL TAXATION RATES

The phenomenon of implicit marginal taxation stems from the connection between the personal income tax system and the transfer programs implemented for the same taxpayers. When the income of certain taxpayers increases, the increase simultaneously results in a decrease in certain transfers these taxpayers benefited from and an increase in their tax burden.

The coexistence of the two separate mechanisms, both defined according to income, can reduce by a relatively significant amount the additional income that a taxpayer obtains in the event their labour income increases.

Implicit marginal taxation rates measure the proportion of one additional dollar in labour income that is collected by the State. These rates provide more complete information on work incentives than basic marginal taxation rates as the *implicit* rates take into account the impacts of all socio-fiscal transfers and the taxation of changes in disposable income resulting from an increase in labour income.

☐ To illustrate

To illustrate a situation in which the implicit marginal taxation rate is high, take as an example a couple with two children and two equal incomes totalling $35,000 and whose labour income increases by $5,000.

As the next table illustrates, the increase in income from $35,000 to $40,000 results in a series of adjustments in the amount of tax and social security contributions payable as well as the socio-fiscal credits to which the household is entitled.

The $5,000 increase in labour income results in an increase in net Québec tax expenses of $2,408 and an increase in net federal tax expenses of $1,507. These amounts include additional tax and social security contributions payable as well as the loss of certain transfers in the form of socio-fiscal credits such as child assistance, the work premium, the solidarity tax credit and the tax credit for childcare expenses.

The $5,000 increase in labour income is therefore offset by a decrease in income of $3,915, which represents an implicit marginal taxation rate of 78.3%.

It should be noted that both governments contribute to the high implicit marginal taxation rate. In the case of this example, the federal government alone accounts for 30.1 percentage points.

TABLE 19

Example of a calculation of implicit marginal taxation rates – Couple with two equal incomes and two children 7 and 9 years of age – 2014

(in dollars per year)

	Before increase in labour income	After increase in labour income	Difference
1. Labour income	**35,000**	**40,000**	**5,000**
2. Québec government			
– Tax(1)	–742	–1,523	–781
– Socio-fiscal credits(2)	8,560	7,659	-901
– QPP contributions	–1,449	–1,708	–259
– QPIP contributions	–196	–224	–28
– Québec drug insurance plan	–139	–507	–368
– Health care contribution	0	–72	–72
Subtotal	***6,034***	***3,626***	***–2,408***
3. Federal government			
– Tax(3)	—	–302	–302
– Socio-fiscal credits(4)	7,144	6,016	–1,128
– Employment insurance contributions	–536	–612	–77
Subtotal	***6,609***	***5,101***	***–1,507***
4. Childcare expenses	–5,920	–5,920	—
5. Net contribution (2+3+4)	6,723	2,808	-3,915
6. Implicit marginal taxation rate (5/1)	—	—	**–78.3**
7. Disposable income	**41,723**	**42,808**	**1,085**

(1) Personal income tax.
(2) Including child assistance, the work premium, the solidarity tax credit and the refundable tax credit for childcare expenses.
(3) Federal personal income tax.
(4) Including the Canada Child Tax Benefit and the refundable GST tax credit.

☐ A problem that is not unique to Québec

The problem with high implicit marginal taxation rates is not unique to Québec or to Canada, although for single-parent families, the problem is more severe in Québec and in Canada than in other OECD countries.

TABLE 20

Implicit marginal taxation rates for a single-parent family with two children – 2012

	Implicit marginal taxation rates for a 1% increase in salary
Germany	51%
Canada	67%
United States	27%
France	27%
Italy	53%
Japan	27%
United Kingdom	32%
Québec	**70%**

Note: For a single-parent family with two children, with the parent earning the average salary for the jurisdiction. Calculated following a 1% increase in income.

Sources: OECD and Ministère des Finances du Québec.

❑ Variable and sometimes unacceptable levels

Several researchers have stressed for many years that implicit marginal taxation rates are reaching unacceptable levels for some households.

One such researcher is the Centre québécois de formation en fiscalité (CQFF), which regularly publishes an analysis of the situation in Québec, most recently on November 21, 2014.

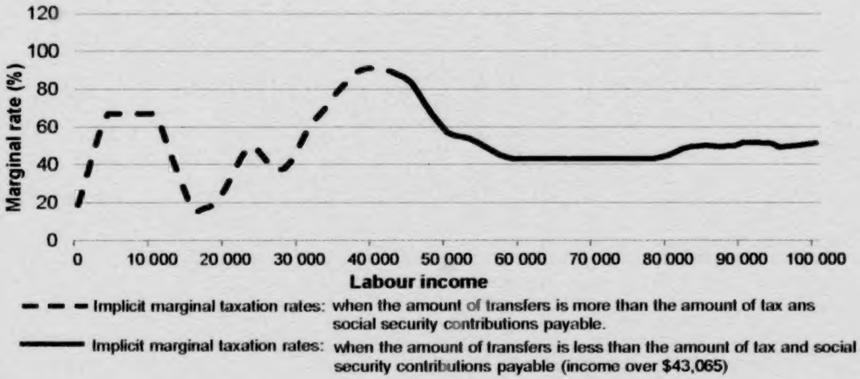
There is also Finn Poschmann, who shows in a study published by the C.D. Howe Institute that tax relief granted by federal and provincial governments effectively increased the implicit marginal taxation rates of low- and middle-income families across Canada.[56]

Not all categories of households are impacted the same by the problem of high implicit marginal taxation rates. A static approach based on the curve of implicit marginal taxation rates plotted against income, as used in the following example, shows the income levels at which taxpayers are hit by high rates.

Thus, as the chart illustrates, for a couple with two children 7 and 9 years of age and two incomes, the implicit marginal taxation rate would be 90.9% at an income level of $40,000.

CHART 11

Implicit marginal taxation rates – Couple with two children 7 and 9 years of age
(rate as a percentage and income in dollars)



Source: Ministère des Finances du Québec.

---

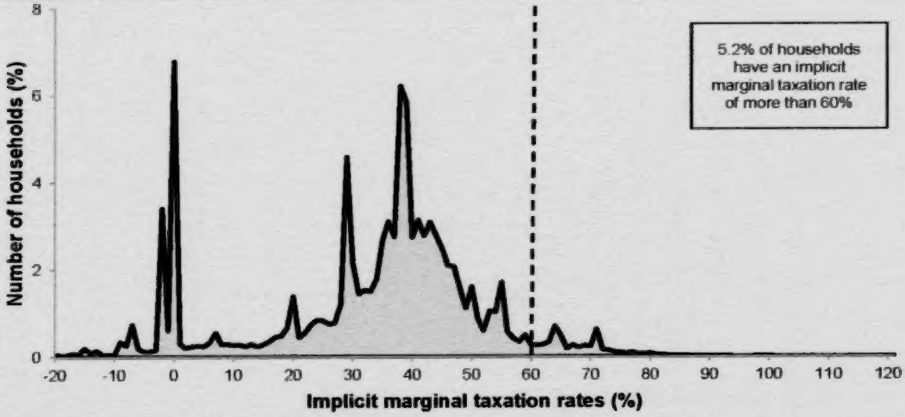
[56] C.D. Howe Institute, *Treading Water: The Impact of High METRs on Working Families in Canada*, by Alexandre LAURIN and Finn POSCHMANN, July 17, 2013.

Another way to examine the question is to compare the percentage of households hit with an implicit marginal taxation rate over a given threshold—for example 60%—by type of household or income group.

Thus, there would be a total of only 5.2% of households with an implicit marginal taxation rate of more than 60%.

CHART 12

Density of implicit marginal taxation rates for all households
(as a percentage)



Source: Ministère des Finances du Québec.

However, the proportions of households with implicit marginal taxation rates above 60% are higher in certain situations, particularly:

- 13.7% in the case of households earning between $10,000 and $20,000
- 12.1% in the case of single-parent families
- 7.1% in the case of couples with children
- 21.3% in the case of single seniors

The factor with the biggest impact on the implicit marginal taxation rates of seniors is the progressive elimination of the guaranteed income supplement, a federal transfer aimed at reducing the impact of poverty on seniors.

TABLE 21

Breakdown of households having an implicit marginal taxation rate above 60% by category of household and by income – 2014
(in thousands and as a percentage)

Category of household	**Number of households** (in thousands)	**Proportion of households with an implicit marginal taxation rate above 60%** (%)
Single individual	1,954	0.8
Childless couple	642	0.4
Single-parent family	290	12.1
Couple with children	678	7.1
Single senior	640	21.3
Senior who is part of a couple	465	0.9
All households	**4,668**	**5.2**
Less than $10,000	396	0.4
$10,000 to $20,000	875	13.7
$20,000 to $30,000	598	5.2
$30,000 to $40,000	504	6.5
$40,000 to $50,000	398	11.2
$50,000 to $75,000	715	1.3
$75,000 to $100,000	454	0.2
$100,000 or more	727	0.4
All households	**4,668**	**5.2**

Source: Ministère des Finances du Québec.

❑ The impact of taxation and social transfers

In a study completed by the Industrial Alliance Research Chair on the Economics of Demographic Change at the request of the Committee, authors Arnaud Blancquaert, Nicholas-James Clavet, Jean-Yves Duclos and Steeve Marchand provide a thorough look into the challenges related to the impact of taxation and social transfers on individual and household behaviour relative to the labour market.

The study, entitled *La fiscalité québécoise et l'incitation au travail,* is available in full in Volume 5 of this report (in French only).

■ The findings

Using an accounting microsimulation model that reproduces the tax and transfer systems in Québec and Ontario, the authors found in particular that:

- Families with children are hit with the highest implicit marginal taxation rates of all households; however, these rates have come down in the last decade.
- Implicit marginal taxation rates are particularly high for households with income under $50,000.
- Furthermore, for this income group, implicit marginal taxation rates vary considerably depending on the household situation.

According to the authors, the overly large variability of implicit marginal taxation rates among individuals or categories of households with similar living standards and characteristics must be corrected.

■ Rates that are cause for concern

The existence of high implicit marginal taxation rates is a cause for concern for a variety of reasons.

- On the one hand, high implicit marginal taxation rates can lead to what is called a "poverty trap" if, in certain situations, low-income households do not have sufficient incentive to increase their labour income.
- On the other hand, it may seem unfair that the tax and transfer system is designed in such a way that low-income households that make the effort to increase their labour income are hit with a significantly higher marginal tax burden than high-income households increasing their income by the same amount.

PART 6:
THE MAIN CHARACTERISTICS OF CORPORATE TAX

The sixth topic addressed by the Committee was the main characteristics of corporate tax.

This section examines:

- The corporate tax burden
- The comparison of corporate income tax rates
- Payroll deductions
- The overall taxation of dividends
- The evolution of corporate income tax rates
- Corporate contributions to the government's own-source revenue
- Corporate use of tax credits

1. THE CORPORATE TAX BURDEN

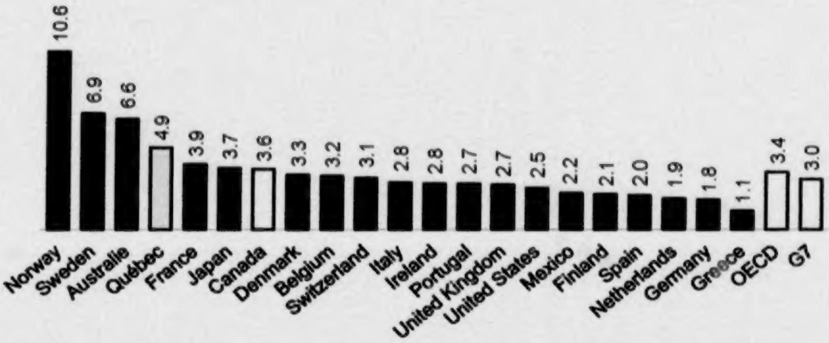
Corporate taxes include in particular corporate income tax, profits tax, capital gains tax and payroll tax (excluding social security contributions).

In Québec, the corporate tax burden represents 4.9% of GDP, compared to 3.6% for all of Canada and 2.5% for the United States.

In general, the corporate tax burden in Québec is higher than the average of OECD countries (4.9% compared to 3.4%).

CHART 13

Weight of corporate tax in Québec and certain OECD countries – 2012
(as a percentage of GDP)



Sources: OECD, data warehouse as at January 30, 2015, and Institut de la statistique du Québec, *Comptes économiques des revenus et dépenses du Québec* (2014 edition).

2. THE COMPARISON OF CORPORATE TAX RATES

☐ An international comparison

With a combined rate of 26.9%, Québec ranks among the average of OECD countries in terms of corporate income tax rates. The combined rate of Québec is also similar to that of Ontario, which is the Canadian representative for OECD data.

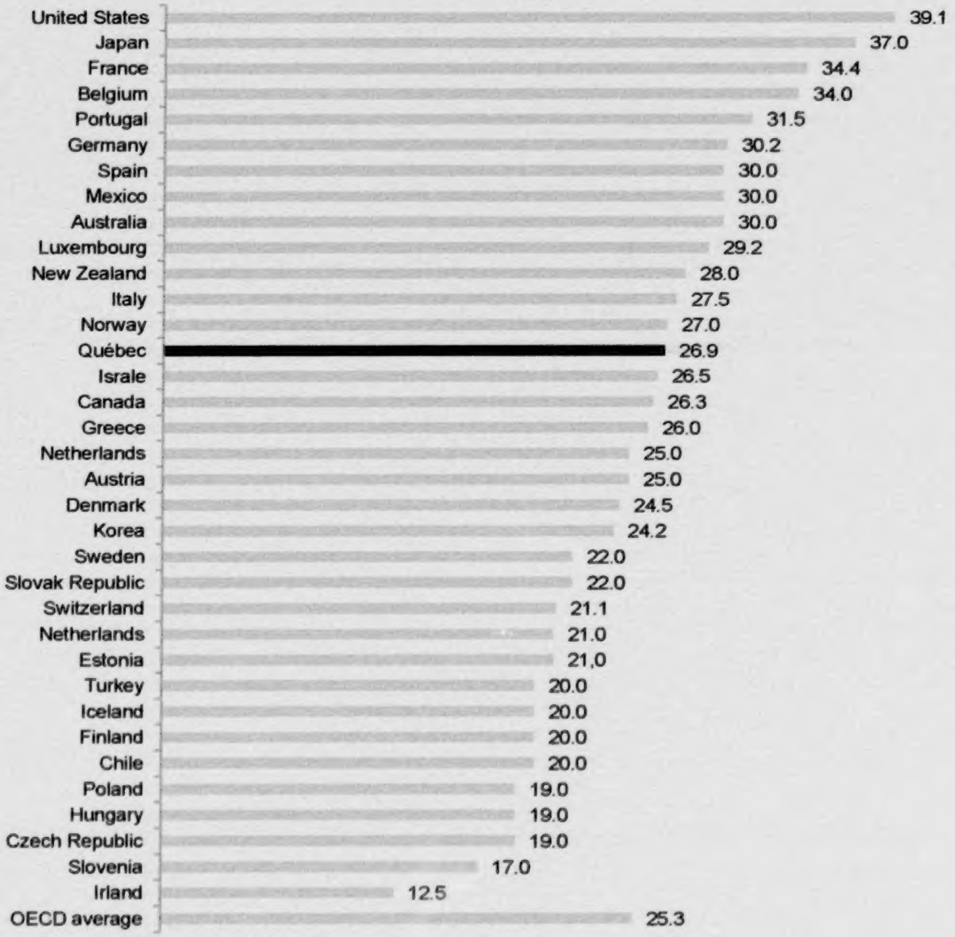
At 25.3%, the average rate of OECD countries is less than Québec's combined rate.

Among OECD countries, the United States, Japan, France and Germany have corporate profits tax rates that are significantly higher than the average rate of OECD countries.

Despite Québec's competitive rate, data shows that three Scandinavian countries—Denmark, Finland and Sweden—have lower corporate tax rates than Québec.

CHART 14

Corporate income tax rates in OECD countries – 2014



Sources: OECD and Ministère des Finances du Québec.

❑ An interprovincial comparison of the general corporate income tax rate

In 2014, following the various tax reforms announced by the provinces, the difference between the Québec rate and the average rate of the other provinces was 0.8 percentage points. Previously, businesses in Québec benefited from the lowest statutory rate among the Canadian provinces.

In 2000, the average general corporate income tax rate in Canada was 15.9%, or 7 percentage points higher than in Québec. This situation was to the advantage of Québec.

Québec is the only Canadian province to have raised its general tax rate between 2000 and 2014, from 8.9% to 11.9 %. The increase represents a jump of 34%.

TABLE 22

Statutory corporate income tax rates – General rates, 2000 and 2014
(as at July 1 of each year, as a percentage)

	2000	2014
Alberta	15.5	10.0
British Columbia	16.5	11.0
Québec	**8.9**	**11.9**
Manitoba	17.0	12.0
Saskatchewan	17.0	12.0
New Brunswick	17.0	12.0
Ontario	14.5	11.5
Newfoundland and Labrador	14.0	14.0
Nova Scotia	16.0	16.0
Prince Edward Island	16.0	16.0
Federal	29.12	15.0
Canadian average[(1)]	**15.9**	**12.7**

(1) Canadian average without Québec and the federal government.

❑ An interprovincial comparison of the rate applicable to small and medium-sized enterprises (SMEs)

In 2014, all of the Canadian provinces except Québec (8%) granted SMEs a reduced tax rate of less than 5%.

It should be noted that the tax rate for SMEs benefits mainly enterprises that do 100% of their business in Québec, have few assets and operate for the most part in sectors where competition is local, such as construction or retail trade.

TABLE 23

Statutory corporate income tax rates of SMEs – 2014
(as a percentage)

	2014
Québec	**8.0**
Ontario	4.5
New Brunswick	4.5
Prince Edward Island	4.5
Newfoundland and Labrador	3.0
Nova Scotia	3.0
Alberta	3.0
British Columbia	2.5
Saskatchewan	2.0
Manitoba	0.0
Canadian average[1]	**3.0**

(1) Canadian average without Québec.

3. PAYROLL DEDUCTIONS

In Canada, payroll tax is imposed by only a minority of provinces, such as Québec with the employer contribution to the Health Services Fund (HSF). The provinces that levy such a tax usually provide for an exemption threshold.

Québec imposes the highest payroll tax rate and, unlike the other provinces, does not allow a basic exemption. Accordingly, the payroll tax applies as of the first dollar of remuneration paid by businesses.

It should be specified that exemptions have a direct influence on the effective rates borne by businesses. The differences between real rates are actually much higher than those between statutory rates alone.

TABLE 24

Payroll tax rates – 2014

(as a percentage, unless otherwise indicated)

	Rate	Exemption
Québec(1)	**2.7 to 4.26**	**—**
Ontario(2)	1.95	$450,000
Manitoba(3)	2.15	$1.25M
Newfoundland and Labrador	2.0	$1.2M
British Columbia	—	—
Prince Edward Island	—	—
Alberta	—	—
Saskatchewan	—	—
New Brunswick	—	—
Nova Scotia	—	—

(1) Since January 1, 2015, SMEs operating in the primary or manufacturing sectors and having a payroll under $5 million benefit from a reduced HSF contribution rate. In general, for eligible employers having a total payroll of $1 million or less, the applicable rate is reduced from 2.7% to 1.6%. For eligible employers having a total payroll of between $1 million and $5 million, the rate is between 1.6% and 4.26%.

(2) The exemption does not apply to private sector employers whose annual total payroll exceeds $5 million.

(3) When annual total remuneration is between $1.25 million and $2.5 million, the rate is 4.3% on the amount in excess of $1.25 million. No exemption is granted if total remuneration exceeds $2.5 million.

4. THE OVERALL TAXATION OF DIVIDENDS

When it comes time to withdraw funds from a corporation, owners can do so one of two ways:

- In the form of salary
- In the form of dividends

If remuneration is paid in the form of salary, it is subject to personal income tax. Additionally, the payment of salary entitles the corporation to a deduction but obligates it to pay certain social security contributions and payroll tax to the government.

If remuneration is paid in the form of dividends, it is subject first to corporate income tax and then to personal income tax. The payment of a dividend does not entitle the corporation to any deduction.

4.1 The principle of integration

To ensure the neutrality of the tax system and avoid double taxation, an integration mechanism exists between personal taxation and corporate taxation to ensure that dividend income is taxed at a similar rate as labour income.

The integration mechanism for dividend income includes two steps:

- Dividends are first grossed up to an amount similar to the before-tax profit of the corporation.
- A tax credit corresponding to the corporate income tax is then applied.

Provincial and federal gross-up and tax credit rates vary depending on whether dividends are common share dividends (corporation eligible for the small business deduction and therefore subject to the reduced tax rate for SMEs) or assessable dividends (corporation subject to the general tax rate).

TABLE 25

Integration mechanism for dividend taxation in Québec – 2014
(as a percentage)

	Common share dividends		Assessable dividends	
	Gross-up	**Credit**	**Gross-up**	**Credit**
Provincial system	18	7.05	38	11.9
Federal system[1]	18	11.02	38	15.02

(1) Before the federal abatement of 16.5%.

☐ A mechanism that is not optimized in Québec

Considering federal corporate income tax rates (11% for SMEs and 15% for large corporations), the integration mechanism is not optimized for the tax rates in effect in Québec (8.0% for SMEs and 11.9% for large corporations).

- The gross-up of 18% for common share dividends reflects a combined tax rate for SMEs of 15.25%, or 11% at the federal level and 4.25% at the provincial level.
- The gross-up of 38% for assessable dividends reflects a combined tax rate for large corporations of approximately 27.5%, or 15% at the federal level and 12.5% at the provincial level.

Thus, at the top personal income tax rate, labour income is taxed at a rate of 49.97% while common share dividends are taxed at a rate of 51.23% and assessable dividends, at a rate of 52.65%.

Despite the integration mechanism, the payment of labour income has a slight tax advantage compared to the payment of common share dividends (1.26 percentage point) or assessable dividends (2.68 percentage points) before applying payroll tax and social security contributions.

TABLE 26

Combined maximum marginal tax rate for labour income and dividends in Québec – 2014

(as a percentage)

	Labour income	Common share dividends	Assessable dividends
Corporate income tax	—	**19**	**26.9**
Provincial	—	8	11.9
Federal	—	11	15
Personal income tax	**49.97**	**32.23**	**25.75**
Provincial(1)	25.75	17.87	13.97
Federal(1),(2)	24.22	14.35	11.78
TOTAL(3)	**49.97**	**51.23**	**52.65**
Difference compared to labour income	—	+1.26	+2.68

(1) Including gross-up and the dividend tax credit.
(2) Including the federal abatement of 16.5%.
(3) Excluding contributions to the Health Services Fund and social security contributions.

4.2 An international comparison

It is interesting to compare the overall taxation of corporate income, including income taxation, at the time it is distributed to shareholders in the form of dividends.

From that perspective, income distributed in the form of dividends is taxed at a considerably higher rate in Québec (52.7%) than the average rate of OECD countries (43.1%).

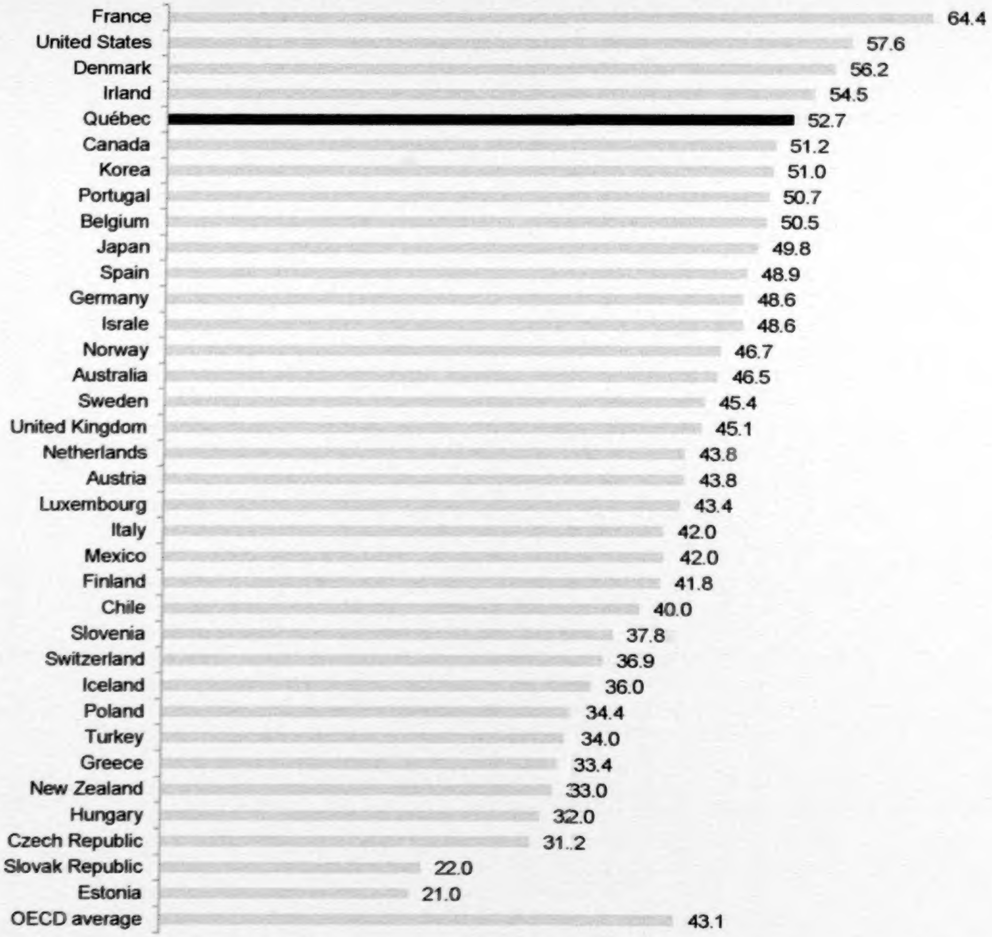
The dividend tax rate in Québec is similar to that in Ontario, which is the Canadian representative in OECD data.

Among G7 countries, the United States and France have dividend tax rates that are significantly higher than those in Québec, but the other G7 countries have lower rates than Québec.

Three Scandinavian countries—Norway, Finland and Sweden—have lower dividend tax rates than Québec.

CHART 15

Dividend tax rates among OECD countries – 2014



Sources: OECD and Ministère des Finances du Québec.

5. THE EVOLUTION OF CORPORATE INCOME TAX RATES

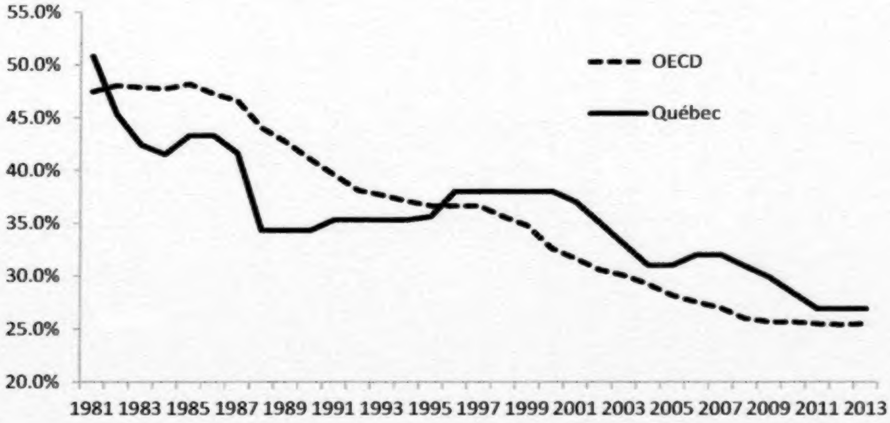
There is a worldwide downward trend in corporate income tax rates. The evolution of statutory corporate income tax rates has been in a markedly downward direction since 1981 in Québec and in terms of the OECD average.

Inversely, during the same period, the weight of corporate tax revenues in proportion to GDP increased in Québec and in terms of the OECD average.

Québec has been following the worldwide trend, with tax rates following a downward trajectory while corresponding tax revenues grow.

CHART 16

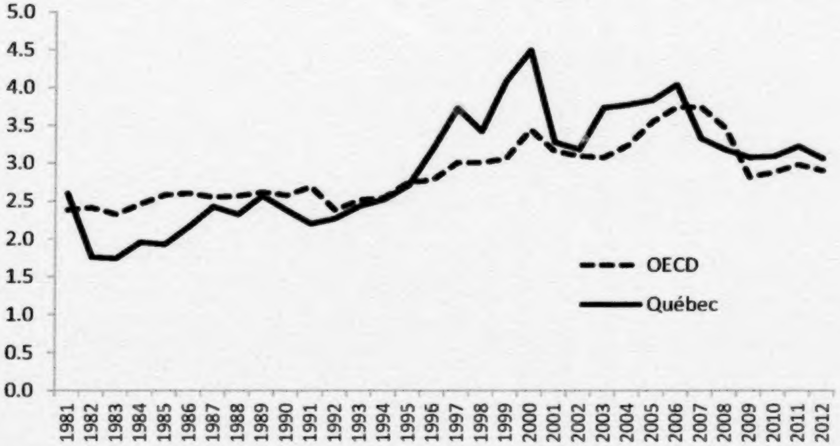
Change in statutory tax rate for corporate income – 1981 to 2013
(as a percentage)



Sources: OECD Tax Database, Canada Revenue Agency and Revenu Québec.

CHART 17

Evolution of the weight of income tax revenues in proportion to GDP – 1981 to 2012
(as a percentage)



Sources: OECD (2014), Institut de la statistique du Québec (2014) and Statistics Canada.

6. CORPORATE CONTRIBUTIONS TO THE GOVERNMENT'S OWN-SOURCE REVENUE

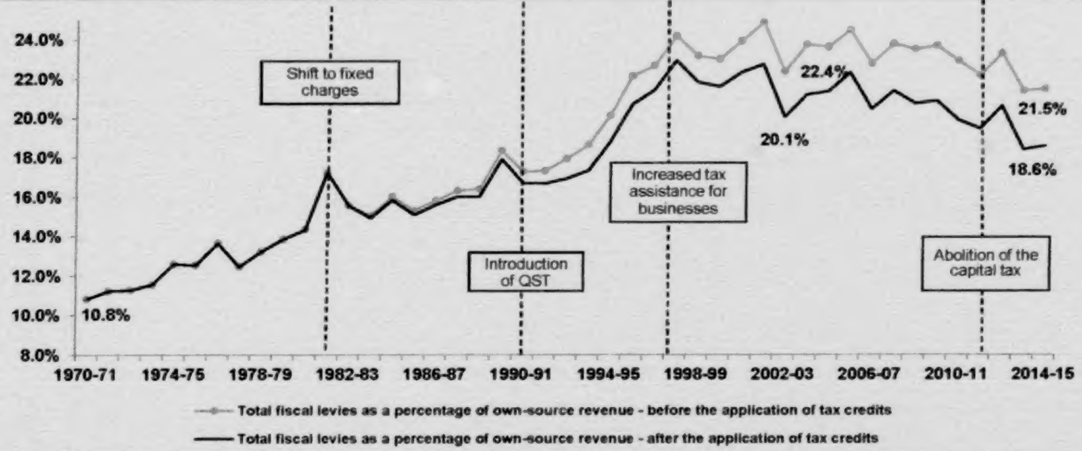
The share of fiscal levies collected from corporations in the government's own-source revenue in its general fund has doubled in 40 years. It will stand at nearly 22% in 2014-2015, compared to 10.8% in 1970-1971.

- During the 1970s, the fight against the deficit was funded in particular by increases in the capital tax and employer contributions to the Health Services Fund.
- The reform of 1981-1982 hastened the shift to fixed charges (the contribution to the Health Services Fund and the capital tax) in order to stabilize revenue and reduce the impact of economic conditions.
- In the early 1990s, the introduction of the QST was beneficial for corporations because it included the reimbursement to corporations of the taxes paid on inputs. This reform was funded in large part through an increase in fixed charges.

It should be noted that for the same period, the gap widened between fiscal levies before and after tax credits, which illustrates the growing importance of tax credits.

CHART 18

Change in fiscal levies on corporations – 1970-1971 to 2014-2015
(as a proportion of the government's own-source revenue)



(1) Total fiscal levies on corporations and payroll tax, including the portion of the payroll tax paid by the public sector.

7. CORPORATE USE OF TAX CREDITS

7.1 The main findings

☐ Strong growth in tax credits

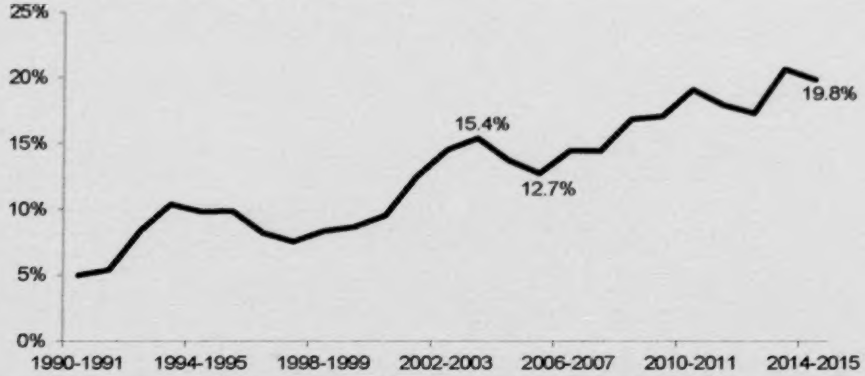
Although tax assistance for businesses has remained relatively stable in recent years, the value of tax credits, which accounts for over 75% of tax assistance for businesses, has grown more rapidly than fiscal levies on corporations.

The cost of tax credits as a proportion of fiscal levies on corporations was 5% in 1990-1991 and will reach 19.8% in 2014-2015, which is an almost fourfold increase.

The tightening of certain tax credits in the 2003-2004 and 2004-2005 budgets slowed the increase for a few years. Nonetheless, the cost of tax credits as a percentage of fiscal levies on corporations has continued to grow.

CHART 19

Change in the cost of tax credits as a proportion of fiscal levies on corporations –1990-1991 to 2014-2015



Note: Total fiscal levies on corporations and payroll tax, excluding the payroll tax paid by the public sector.

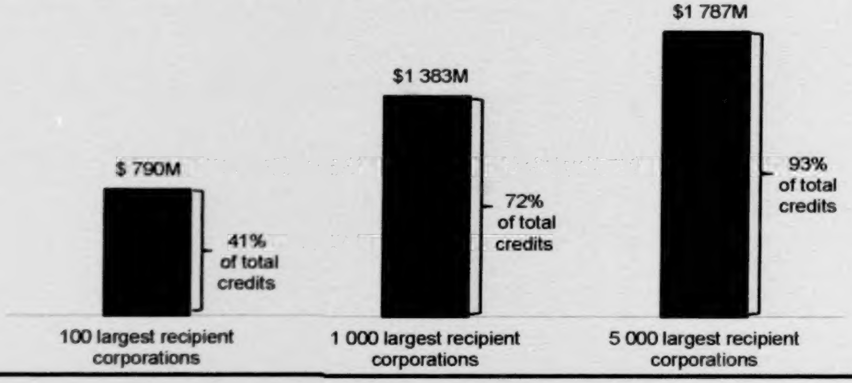
☐ A limited number of recipient corporations

A large proportion of tax credits are granted to a limited number of corporations. Based on the 2011 data, it should be noted that out of the 16,990 corporations that receive tax credits or 4% of all corporations:

- 100 corporations, or less than 1% of recipient corporations, were granted over 40% of the total amount of tax credits ($790 million).
- 1,000 corporations, or less than 6% of recipient corporations, were granted over 70% of the total amount of tax credits ($1,383 million).
- 5,000 corporations, or 29% of recipient corporations, were granted over 90% of the total amount of tax credits ($1,787 million).

CHART 20

Proportion of total tax credits granted, by group of recipient corporations – 2011



7.2 Certain key tax credits

The following pages provide a brief description of certain key tax credits for corporations as well as a comparison of these tax credits and the assistance available in other jurisdictions when relevant or available.

This section examines:

- Tax credits relating to the new economy
- Tax credits relating to corporate investment
- The Scientific Research and Experimental Development Tax Credit
- Tax credits relating to culture

❑ Tax credits relating to the new economy

Like for several other key areas pertaining to tax assistance for businesses, the Committee asked a group of experts to help it better understand the impacts of these credits on the economy and the sectors in question.

The firm E&B Data was therefore hired to complete a study of the tax credits relating to the new economy, entitled *Revue des programmes de crédits d'impôt à la Nouvelle Économie.*

The firm looked at two programs pertaining to the new economy—those for the development of e-business and the production of multimedia titles. It assessed the relevance of the programs, their profitability for public finance and their economic effectiveness.

A more detailed assessment can be found in the study, which is available in full in Volume 5 of this report (in French only).

■ The tax credit for the development of e-business

This tax credit was introduced in 2008 with the main purpose of consolidating the information technology sector in Québec.

The tax credit is 24% following the tightening measures of June 2014, and it has an annual cap of $20,000 per employee and a minimum requirement of six eligible employees.

The tax credit is for corporations specializing in the information technology sector, mainly in the areas of computer system design and software publishing.

On July 11, 2013, the government extended the end date of the measure from December 31, 2015, to December 31, 2025.

Certain information technology tax assistance programs around the world – 2014

	Credits		
Region	**Min.**	**Max.**	**Eligible expenses**
California	55%	55%	Tax reduction for the acquisition of eligible equipment
Catalonia	20%	30%	Project subsidy with optional loan
China	40%	40%	Tax rate reduced from 25% to 15%
India	50%	100%	Tax exemption on export income
	Nil	Nil	Subsidy for leasing costs based on the surface area of the facility
Louisiana	25%	35%	Refundable tax credit for salary expenditures (no cap) and eligible equipment
Malaysia	70%	70%	Tax exemption
Massachusetts	—	$1,500,000	Loan for the acquisition of equipment
Minnesota	Nil	Nil	Acquisition of eligible equipment and all essential expenses
New York	Variable	Variable	Three tax credits, on salaries ($1,000, refundable), employee training (capped at $250,000, refundable) and investments (10% to 20%, non-refundable)
	100%	100%	All taxes paid (non-refundable)
New Mexico	10%	10%	Tax credit for eligible salary expenditures
Seoul	50%	100%	All taxes paid eligible for refund
Ukraine	75%	75%	Tax rate reduced from 21% to 5%

Source: E&B Data, *Revue des programmes de crédits d'impôt à la Nouvelle Économie*, December 2014.

■ The tax credit for the production of multimedia titles

The tax credit for the production of multimedia titles is a permanent measure that was introduced in 1996 with the main purpose of expanding the production of multimedia titles in Québec.

Eligible expenses include the salaries of employees working directly on multimedia titles. The rate varies between 21% and 30% depending on the title category.

- Category 1 (24%) pertains to titles meant to be commercialized.
- An additional 6% may be added for category 1 titles available in French.
- Category 2 (21%) pertains to other titles including occupational training titles.

Unlike the tax credit for the development of e-business, this credit has no annual cap per eligible employee.

Québec was a trail-blazer for this type of assistance. Most programs elsewhere have been introduced only recently.

TABLE 27

Selection of tax assistance programs for the production of video games – 2014

	Credits			
Region	**Min.**	**Max.**	**Type of credits**	**Eligible expenses**
Québec	**21%**	**30%**	**Refundable**	**Eligible salary expenditures**
Nova Scotia	30%	60%	Refundable	Eligible salary expenditures
Manitoba	40%	40%	Refundable	Salary expenditures
Ontario	35%	40%	Refundable	Eligible salary expenditures
New Brunswick	30%	30%	Refund	Salary expenditures for provincial residents
Prince Edward Island	25%	25%	Refund	Eligible salary expenditures
British Columbia	17.5%	17.5%	Refundable	Eligible salary and commercialization expenditures
Virginia	15%	40%	Refundable	Expenses and salaries
Alabama	25%	35%	Refund	Expenses and salaries of state residents
Louisiana	25%	35%	Refundable	Local expenses and salaries of state residents
Ohio	25%	35%	Refundable	Expenses and salaries of state residents
Michigan	25%	35%	Refundable	Eligible expenses
Mississippi	25%	30%	Refund	Initial investment and salaries of local residents
New Mexico	25%	30%	Refundable	Expenses and eligible salaries
Florida	20%	30%	Transferable	Expenses and salaries
Georgia	20%	30%	Transferable	Expenses and salaries
Connecticut	10%	30%	Transferable	Local expenses
Wisconsin	25%	25%	N/A	Expenses and salaries
Rhode Island	25%	25%	N/A	Expenses and salaries
Hawaii	20%	25%	Refundable	Local expenses and salaries of state residents
Texas	5%	22.5%	Subsidy	Local expenses and salaries of state residents
Arkansas	10%	20%	Refund	Expenses and salaries of state residents
Colorado	20%	20%	Refund	Local expenses
Kentucky	20%	20%	Refundable	Eligible expenses and taxes
New Jersey	20%	20%	N/A	Expenses and salaries
North Carolina	15%	20%	Transferable	Research expenditures and salaries
Maine	5%	12%	Refund	Expenses and salaries of state residents
Seoul	50%	100%	Non-refundable	Tax on income generated by eligible activities
Singapore	40%	50%	N/A	Refund of expenses
United Kingdom	25%	25%	N/A	All basic expenses deemed essential
France	20%	20%	Refundable	Expenses and eligible salaries

Source: E&B Data, *Revue des programmes de crédits d'impôt à la Nouvelle Économie*, December 2014.

☐ Tax credits relating to corporate investment

To fully understand the impact of tax measures relating to investment both nationally and internationally, the Committee asked external experts to conduct two studies.

— The first study, entitled *Rapport sur les mesures fiscales favorisant l'investissement*, was conducted by the firm Raymond Chabot Grant Thornton. The study compares Québec's tax system for investments with that of the other Canadian provinces and other countries. The study summarizes key elements of certain tax measures aimed at stimulating investment that exist in other jurisdictions. It also compares the costs of certain investment projects for a corporation in different jurisdictions based on the tax measures available for investments.

— The second study, entitled *Fiscalité et aide publique aux entreprises – Revue de la littérature et analyse*, was conducted by the Institut du Québec. The Institut first reviews the main reports and research documents pertaining to tax assistance for businesses and the determinants of investment. Afterwards, it summarizes the conceptual and empirical models linking investment to the tax burden of businesses.

The studies are available in full in Volume 5 of this report (in French only).

The investment tax credit

The basic rate of the investment tax credit (ITC) for manufacturing and processing equipment is 4% following the tightening measures of June 2014.

The rate is increased[57] to 8% for SMEs operating in central regions and up to 32% for qualified expenditures incurred by SMEs in the remote zone.

Qualified investments[58] include:

- Depreciable property in classes 29 or 43 acquired after March 13, 2008, but before January 1, 2018
- Property acquired after March 13, 2008, but before January 1, 2018, to be used primarily in processing activities involving foreign ore
- Property to be used primarily in smelting, refining and hydrometallurgy activities involving ore (other than ore from a gold or silver mine) extracted from a mineral source located in Canada, and that was acquired after March 20, 2012, but before January 1, 2018
- General-purpose electronic data processing equipment and systems software for that equipment, including ancillary data processing equipment (property belonging to class 50) acquired after January 31, 2011, but before January 1, 2018, to be used primarily in manufacturing and processing

The increased rate[59] of this tax credit is determined based on the consolidated paid-up capital of the corporation and its associated corporations:

- It is fully refundable if the paid-up capital is $250 million or less.
- It is partially refundable if the paid-up capital is between $250 million and $500 million.
- It is non-refundable if the paid-up capital is more than $500 million.

The portion of the tax credit that is non-refundable can be carried forward 20 years or carried back 3 years.

---

[57] A qualified corporation can benefit from an increased rate for a taxation year only on its qualified investments that do not exceed the cumulative limit of $75 million.

[58] To qualify for the tax credit, the property must be new and used solely in Québec and mainly for the purpose of carrying on a business. Additionally, the corporation must have begun to use the property within a reasonable time after acquiring it and must use it for a minimum of 730 days. The property must also not be used in a recognized business in connection with a major investment project.

[59] A qualified corporation can benefit from the refundable portiion of the ITC for a taxation year only on its qualified investments that do not exceed the cumulative limit of $75 milllion.

- **Change made**

A change was made in the December 2, 2014 *Update on Québec's Economic and Financial Situation*:

— Businesses can benefit from this tax credit only for qualified expenditures exceeding $12,500.

This change applies to qualified property acquired after December 2, 2014, with the exception of:

— Qualified property acquired in accordance with a written obligation contracted no later than December 2, 2014

— Qualified property of which construction by the qualified corporation began before December 2, 2014

TABLE 28

Investment tax credit rates based on the size of the business and the region where the qualified expenditures were incurred
(as a percentage)

	Current system
Paid-up capital less than $250 million	
Central regions	8
Intermediate zone(1)	16
Bas-Saint-Laurent	
Western part	16
Eastern part(2)	24
Remote zone(3)	32
Paid-up capital greater than $500 million	
Central regions	4
Intermediate zone (1)	4
Bas-Saint-Laurent	
Western part	4
Eastern part(2)	4
Remote zone(3)	4

Note: The increased rate of the tax credit decreases linearly for paid-up capital of between $250 million and $500 million.

(1) Saguenay–Lac-Saint-Jean (code 02), Mauricie (code 04) as well as the RCMs of La Vallée-de-la-Gatineau (code 50) and Pontiac (code 51) in the Outaouais region and the RCM of Antoine-Labelle in the Laurentides region (code 52).

(2) The RCMs of La Matapédia, La Matanie and La Mitis.

(3) The remote zone includes Abitibi-Témiscamingue (code 08), Côte-Nord (code 09), Nord-du-Québec (code 10) and Gaspésie–Îles-de-la-Madeleine (code 11).

Tax holidays for large projects

Since November 2012, the Québec government has been granting a corporate income tax holiday as well as a holiday from employer contributions to the Health Services Fund for a maximum period of 10 years when a corporation carries out a large investment project.

To benefit from this holiday, corporations must apply for a certificate before November 21, 2015.

Eligible sectors include manufacturing, wholesale trade, warehousing and storage, and data processing and hosting. Investments must exceed $200 million, and the holiday may not exceed 15% of eligible investment expenditures.

❑ The tax credit for scientific research and experimental development

The Committee asked a group of experts to conduct a study to fully understand the economic impacts of the tax credit for scientific research and experimental development.

The study, entitled *Le soutien fiscal à la recherche et développement au Québec*, was completed by KPMG.

One purpose of the study was to compare Québec's research and development tax system and those of other jurisdictions, particularly in terms of base rates, rates available for different types of projects and the expenditures that qualify. KPMG also compared the costs for research and development projects in different jurisdictions.

The study is available in full in Volume 5 of this report (in French only).

■ The parameters of the tax credit

There are essentially three criteria for work to be considered research and development:

- The corporation must demonstrate scientific or technological advancement.
- The corporation must identify scientific or technological uncertainty.
- The activities must include scientific or technical content.

Qualified expenditures include salaries or 50% of the amount of a subcontract for corporations with less than $50 million in assets.

For SMEs, the rate is 30%. A linear reduction in the rate of the tax credit (from 30% to 14%) applies in the case of corporations with assets of $50 million to $75 million.

For large enterprises with assets of more than $75 million, the rate is 14% and the tax base remains the same.

The tax credit for SMEs applies to the first $3 million in annual expenditures. For expenditures over that amount, the rate is 14%.

The tax credit is fully refundable in all circumstances.

TABLE 29

Research and development tax credits, federal and provincial, by enterprise size

	Fed.	Que.	B.C.	Alta.	Sask.	Man.	Ont.	N.B.	N.S.	N.L.
SMEs	35%	30%	10%	10%	15%	20%	10% + 4.5%	15%	15%	15%
• Qualified expenditure limit	$3M	$3M	$3M	$4M			$3M			
Large enterprises	15%	14%	10%	10%	15%	20%	4.5%	15%	15%	15%
• Qualified expenditure limit				$4M						

Source: Information concerning existing assistance in other provinces can be found in the study by KPMG.

■ Changes made

Changes were made in the December 2, 2014 *Update on Québec's Economic and Financial Situation*.

The minimum qualified expenditure thresholds for all scientific research and experimental development tax credits will be:

- $50,000 for corporations with assets of $50 million or less
- $225,000 for corporations with assets of $75 million or more
- An amount that increases linearly between $50,000 and $225,000 for corporations with assets of between $50 million and $75 million

■ Three other tax credits

There are three other refundable research and development tax credits available, applicable to university research contracts, private partnership agreements and dues paid to research consortiums.

The rate of these credits was 28% before December 3, 2014.

Tax legislation was amended to standardize rates applicable to refundable research and development tax credits for expenditures incurred after December 2, 2014, relative to university research contracts, private partnership agreements and dues paid to research consortiums committed to after that date.

- **Commercialization**

European countries are increasingly using "patent box" type incentives.

These incentives often take the form of a partial or full tax exemption on a corporation's intellectual property-related income. The purpose of these incentives is to encourage corporations carrying out research and development to use and commercialize innovations in the country in which the research and development was conducted.[60]

Currently, nine countries, including eight European countries, have such a measure.

The report reviewing federal support to research and development, which was published in 2011 by a panel led by Thomas Jenkins, recommends complementary initiatives to support commercialization.[61] The report proposes to implement a new commercialization voucher pilot program to help SMEs connect with innovation partners.

---

[60] These incentives are described in the study by KPMG, pp. 82–84.

[61] Thomas JENKINS, *Innovation Canada: A Call to Action. Review of Federal Support to Research and Development – Expert Panel Report*, 2011.

❑ Tax credits relating to culture

The Committee hired the firm KPMG to conduct a study to better understand the importance of tax credits for firms operating in this sector. The study, entitled *Analyse des mesures fiscales destinées aux entreprises du secteur culturel,* is available in Volume 5 of this report (in French only).

The study presents, among other things:

- A portrait of the evolution of different types of cultural productions in the last 10 years, highlighting the use of tax assistance
- A financial analysis of a sample of businesses operating in the cultural sector
- An analysis of the impact of a change to tax measures on the financial situation of these businesses
- An analysis of development factors for cultural businesses, other than operating costs

The study offers some general observations.

- The stability and foreseeability of tax credits are especially important for industries requiring long-term commitments, particularly the production of shows (tour engagements) and televised series.
- Tax credits enable businesses to produce products they would not have otherwise been able to produce. Tax credits provide a diversified offering of cultural products, even though certain businesses report suffering from an overly abundant offering.

This section examines tax credits relating to culture for the following sectors:

- Québec film and television production
- Film production services (film shooting abroad)
- Dubbing
- Sound recordings
- Book publishing
- Production of shows

- **The tax credit for Québec film and television production**

The tax credit for Québec film and television production was introduced in 1990 to create conditions that are conducive for the independent production and technical and technical services industries to have better access to the capital necessary for expansion, consolidation and market extension.

This sector of activity receives just over 50% of tax assistance provided to cultural businesses.

The basic rate of the tax credit is 28%, but increased rates are granted for French-language productions, regional productions, special effects or digital animation and productions that do not receive public funding.

The basic rate in Québec is slightly less than that of other Canadian provinces.

TABLE 30

Comparison of the tax credit for Québec film and television production with that of Ontario and British Columbia
(as a percentage)

	Québec	Ontario	British Columbia
Basic rate	28	35	35
Rate increases			
– French-language	8	—	—
– Large format	8	—	—
– No public funding	8	—	—
– Regional	16(1)	10	12.5
– Remote regions	—	—	6.0
– Special effects and digital animation	8	20	17.5

(1) Limited to 8% if the rate is already increased.
Source: Ministère des Finances du Québec.

Since December 3, 2014, the tax credit is calculated based on eligible labour costs plus 2%. Generally, at least 75% of production costs must be paid to Québec residents. Additionally, eligible labour costs may not exceed 50% of production costs.

KPMG assessed the impact of the tax credit rate reduction announced in the 2014-2015 budget of June 2014 on the profitability of the industry, measured in earnings before interest, tax, depreciation and amortization (EBITDA).

— For businesses with earnings of more than $10 million, profitability decreased from 19% to 18%.

— For businesses with earnings of less than $10 million, profitability slipped from 3% to 0%.

According to the KPMG study, the animation sector seems to be confronted with its own unique challenges, including the ability to attract and retain skilled labour. For salary-related reasons, labour tends to leave for abroad or for the video game sector.

■ The tax credit for film production services

This tax credit was introduced in 1998 and applies only to labour costs. The tax credit was implemented to encourage foreign producers to shoot films in Québec and to stimulate job creation.

The tax credit became applicable to all eligible costs in 2009.

The basic rate of the tax credit is 20%, and it is applicable to all eligible production expenses. A 16% increase for eligible labour costs is granted for special effects and animation.

According to KPMG, tax assistance, local production costs and landscapes are the deciding factors in a company's decision to shoot in Québec.

Québec is considered one of the most appealing areas in North America for production services, not only because of the tax credit offered, but also because of the stability and longevity of the credit.

KPMG also reported that the EBITDA of all sizes of businesses in this sector decreased from 3% to 1% following the June 2014 reduction of the tax credit rate.

However, based on the results of the analyses of the identified economic and tax benefits,[62] the tax credit for film production services does not seem to satisfy the tax profitability ratio criterion, which puts into question its merit.

---

[62] See below, p. 162.

TABLE 31

Comparison of tax credits granted for foreign film production services in select provinces

Province	Basic credit	Eligible expenditures	Limit	Regional increase	Increase for special effects
Québec	20%	Labour, goods and services	—		16% of labour costs eligible in Québec
Ontario	25%	Labour, goods and services	—		20% of labour costs eligible in Ontario
British Columbia	33%	Eligible labour costs	—	6% if > 50% of scenes are shot outside Vancouver + 6% if remote regions	17.5% of labour costs eligible in British Columbia
Louisiana	30%	Expenditures directly related to production in Louisiana Minimum expenditures of $300,000	—		The credit also applies to special and visual effects
New York	30%	Eligible production costs (including postproduction)	$420M per year		The credit also applies to special and visual effects
California	20% to 25%	Eligible production costs	$100M (2014-2015) to $230M (2015-2016)		

Source: KPMG, *Analyse des mesures fiscales destinées aux entreprises du secteur culturel*, p. 3.

■ The tax credit for film dubbing

The tax credit for film dubbing was introduced in 1997 to support dubbing activities in Québec and to enable businesses in this industry to extend their market.

The tax credit applies to eligible labour costs at a rate of 28%. A maximum of 45% of the remuneration paid for services is applicable.

KMPG highlights the following points in its study:

- Labour costs related to eligible dubbing activities represent 60% of business expenditures.
- The 20% tax credit reduction announced in spring 2014 decreased the EBITDA of all businesses from 8% to 6%, regardless of their size.
- International competition is increasingly strong and coming from countries such as Belgium, Spain and Morocco, which offer lower prices and more flexible working conditions.
- High labour costs compared to those of competitors are difficult to correct due to strong unionization in the artist community.

The tax credit for the production of sound recordings

The tax credit for the production of sound recordings was introduced in 1999 with the purpose of:

- Supporting record production businesses, particularly with the production of Québec content
- Stimulating job creation
- Encouraging business capitalization and industry consolidation

The tax credit rate is 28% of eligible costs that are committed to and paid for. A certificate of eligibility must be issued by SODEC, and eligible expenses may not exceed 50% of total production costs for the eligible recording.

KPMG points out the fact that businesses in this sector were already reporting EBITDA of –3% prior to the 20% tax credit reduction announced in June 2014.

KPMG also presents the following findings:

- The sound recording industry in Québec has been reporting decreasing revenues for a few years now.
- With the arrival of digital recordings, Québec's industry saw a decrease in the market share of Québec and Francophone artists.
- Digital recordings impose additional marketing costs, but revenues are far from sufficient to offset decreased CD sales.
- The business risk is greater, because businesses must assume development, production and commercialization costs.
- Of all the tax credits granted for culture, the tax credit for sound recordings represents the smallest amount—less than $1.5 million per year.

The tax credit for book publishing

The tax credit for book publishing was introduced in 2000 in order to:

- Support businesses in the sector
- Enable publishers to develop foreign markets, produce major publishing projects and operate in the translation market

In 2011, the eligibility parameters of the tax credit were expanded to include digital versions of books.

Eligible works are works by a Québec author or a group of authors at least 50% of whom are from Québec.

The tax credit rate is 28% of the qualified labour expenditure attributable to publishing preparation costs and 21.6% of the qualified labour expenditure attributable to printing costs for the work or the group of works. The qualified labour expenditure is limited to 50% of all preparation costs directly attributable to the preparation of the work and all digital version publishing costs, as well as 33.3% of printing costs directly attributable to the printing of the work.

The maximum tax credit is $350,000 for a qualifying work or for each work in a group of works.

KPMG points out that the tax credit reduction of June 2014 reduced the EBITDA of businesses with sales of less than $1 million from 12% to 11% and that of businesses with sales of more than $1 million from 15% to 14%.

■ The tax credit for the production of shows

This tax credit was introduced in 1999 to support the production of music, theatre, comedy, mime or magic shows.

The purpose of the tax credit is to:

- Encourage the consolidation of the industry
- Enable the production of shows with more ambitious budgets
- Support job creation

The tax credit rate is 28% for eligible labour expenditures related to an eligible production.

Eligible expenditures are limited to 50% of total production costs related to the eligible show. The tax credit threshold is $1 million for musical comedies and $600,000 for all other productions.

KPMG points out that the 20% tax credit reduction decreased the EBITDA of businesses with earnings of less than $1.5 million from 1% to −0.2% and that of businesses with earnings of more than $1.5 million from 7% to 5%.

KPMG also presents the following findings:

- Assistance has been decreasing in all sectors for the past five years.
- Large-scale magic, comedy and circus shows have progressed more than music and theatre productions.
- The producer finances production, marketing and promotion.
- Funding is dependent on the success of productions and ticket sales.

PART 7:
THE MAIN CHARACTERISTICS OF CONSUMPTION TAX

The seventh topic addressed by the Committee was the main characteristics of consumption tax.

To fully understand the specificities of consumption tax and consider them in an international perspective, the Committee asked Alain Charlet, member of the OECD Consumption Tax Technical Advisory Group and an independent expert for the International Monetary Fund, and Stéphane Buydens, advisor on value-added tax policy for the OECD Centre for Tax Policy and Administration, to conduct a study, which is entitled *L'expérience internationale et les tendances actuelles en matière d'impôts sur la consommation.*

The study is available in full in Volume 5 of this report (in French only).

The purpose of the study was to clarify the following items and provide the Committee with an international perspective of them:

- The different forms of consumption tax
- Recent changes to consumption taxes
- The increase in government revenues relating to consumption tax
- The question of tax rebalancing in favour of consumption tax

This section examines:

- The weight of taxes on goods and services
- A comparison of value-added tax levied in OECD countries
- The scope of the value-added tax base
- The levying of sales tax on certain tax-free goods in Québec
- Specific taxation
- Green taxation
- The problem with collecting sales tax on e-business

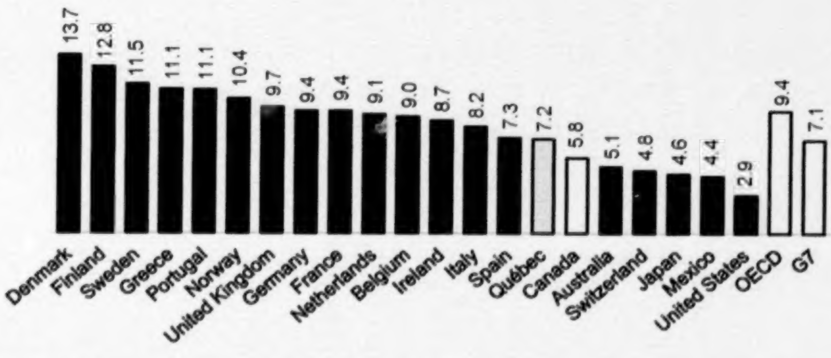
1. THE WEIGHT OF TAXES ON GOODS AND SERVICES

Taxes on goods and services (retail sales tax and excise tax) represent 7.2% of GDP in Québec compared to 5.8% in Canada as a whole and 2.9% in the United States.

The consumption tax rate levied in Québec is less than the average rate of OECD countries, which is 9.4% of GDP.

CHART 21

The weight of taxes on goods and services in Québec and certain OECD countries – 2012
(as a percentage of GDP)



Sources: OECD, data warehouse as at January 30, 2015, and Institut de la statistique du Québec, *Comptes économiques des revenus et dépenses du Québec* (2014 edition).

2. A COMPARISON OF VALUE-ADDED TAX LEVIED IN OECD COUNTRIES

☐ An international comparison

With a sales tax rate (GST and QST combined) of 14.975%, Québec falls below the average rate of OECD countries, which is 19.1%.

Among OECD countries, the United States represents a unique case, as it is the only country to not have value-added tax (VAT). Some states collect sales tax, but others do not.

In total, 21 of the 34 OECD countries have a VAT rate of 20% or more. Among European G7 countries, the rate varies between 19% and 22%, which is similar to the average rate of OECD countries.

With a combined federal and provincial rate of 14.975%, Québec has one of the lowest rates of the jurisdictions studied, with the exception of Japan (5%).

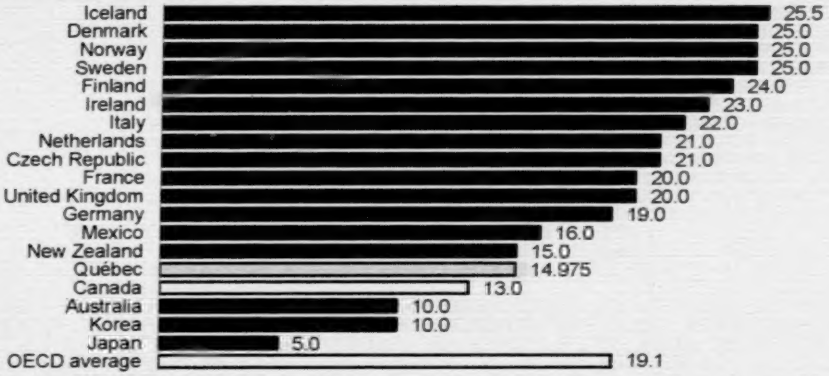
Among Scandinavian countries, there appears to be a consensus, as Denmark, Norway and Sweden all have a rate of 25%. In Finland, the rate is 24%.

Between 2000 and 2014:

- The average VAT rate of OECD countries increased 1.1 percentage points, from 18% to 19.1%.
- A total of 21 countries increased their tax rate.
- Seven countries increased their tax rate to over 20%.

CHART 22

Consumption tax rates in OECD countries – 2014
(as a percentage)



Sources: OECD and Ministère des Finances du Québec.

☐ An interprovincial comparison

The majority of provinces levy a combined federal and provincial sales tax rate of 13%.

Québec has the second-highest combined tax rate (14.975%), second to Nova Scotia at 15%. Alberta is the only province to not levy provincial sales tax; only GST is collected there.

TABLE 32

Consumption tax rates in Canadian provinces – 2014

	Provincial sales tax	GST[1]	Combined rate
Alberta	0%	5%	5%
Saskatchewan	5%	5%	10%
British Columbia	7%	5%	12%
Newfoundland and Labrador[2]	8%	5%	13%
New Brunswick[2]	8%	5%	13%
Ontario[2]	8%	5%	13%
Manitoba	8%	5%	13%
Prince Edward Island[2]	9%	5%	14%
Québec	**9.975%**	5%	**14.975%**
Nova Scotia[2]	10%	5%	15%
Average[3]	**8.1%**	**5%**	**12.3%**

(1) The GST or the federal portion of the HST.

(2) These provinces levy HST. The provincial sales tax and GST values therefore correspond to the provincial and federal portions of HST, respectively.

(3) For the provincial sales tax, the average represents that of the provinces that levy such a tax (excluding Alberta), and for the combined rate, the average represents that of all of the provinces including Alberta.

3. THE SCOPE OF THE VALUE-ADDED TAX BASE

This section on the scope of the sales tax base is based on the study *L'expérience internationale et les tendances actuelles en matière d'impôts sur la consommation* completed by Alain Charlet and Stéphane Buydens at the request of the Committee.

The study is available in full in Volume 5 of this report (in French only).

☐ The VAT revenue ratio

The OECD created an indicator to measure the effectiveness of a VAT collection regime—the VAT revenue ratio. This indicator measures the difference between the theoretical revenue from a "pure" VAT regime (supposing a single rate, perfect fiscal discipline and full tax collection) and the revenue actually collected.[63]

This ratio is the result of the relationship between the amount of VAT actually collected and the amount that theoretically would have been collected had the VAT been levied at a single rate on all final consumption.[64] For example, a ratio of 0.6 means that only 60% of taxes that could potentially be collected actually are.

In this sense, the VAT revenue ratio is an indicator of the effects of exemptions, reduced rates, VAT registration thresholds and a lack of fiscal discipline regarding the collection of VAT revenue.

---

[63] OECD, "Measuring performance of VAT", Chapter 3 of *Consumption Tax Trends 2014: VAT/GST and excise rates, trends and policy issues*, OECD Publishing, 2014.

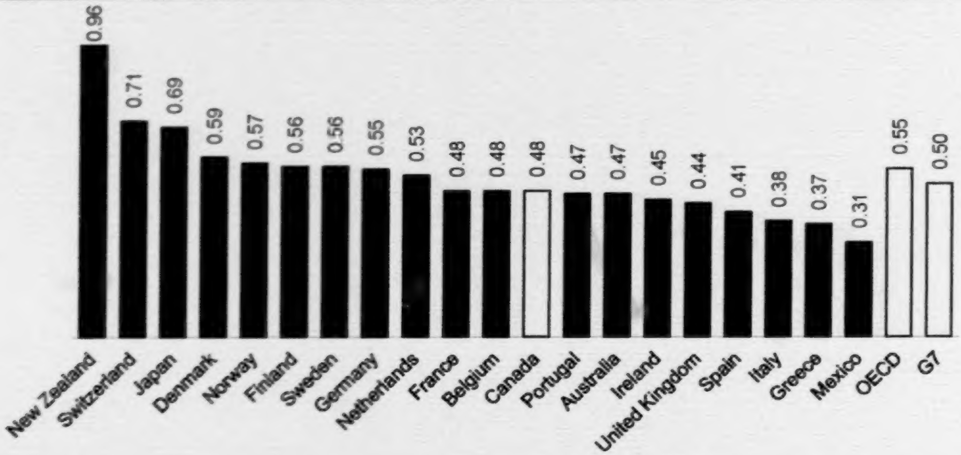
[64] For the purpose of calculating the ratio, "final consumption" is considered to correspond to national consumption figures taken from national accounts. However, this correspondence is not exact because, for example, investment goods, which are subject to VAT, are not included in the consumption of national accounts. Ibid.

The VAT revenue ratio in Canada was 0.48 in 2012, which was below the average ratio of OECD countries (0.55 in 2011 and 2012)[65] and the same as that in Australia (0.47) and France (0.48). It was very different than that in New Zealand (0.96), which is the basis of "second generation" VAT models and inspired the Canadian model. Canada's low ratio was an indication of a tax base eroded by numerous tax-free statuses and tax exemptions.

This indicator is not calculated for Québec,[66] but logically, the ratio in Québec should be relatively similar to that in Canada.

CHART 23

VAT revenue ratios of OECD countries – 2012



Source: OECD.

---

[65] OECD, *supra*, Figure 3.1, "VAT Revenue Ratio 2012", and Table 3.1, "VAT Revenue Ratio (VRR)".

[66] The ratio in Québec would not be much different than that in Canada, because QST is now harmonized with GST for the most part.

4. THE LEVYING OF SALES TAX ON CERTAIN TAX-FREE GOODS IN QUÉBEC

With the tax-free status of groceries, pharmaceuticals and books, Québec and Canada (in terms of the GST-exempt status of groceries and pharmaceuticals) have somewhat similar measures in place as certain European Union member states such as Ireland and the United Kingdom, although not all products in question are subject to a rate of zero in those two countries.

No other European Union member states levy a rate of zero on these three types of products. Only two countries, Bulgaria and Denmark, levy the general VAT rate on these three types of products. Three countries—Estonia, Lithuania and Slovak Republic—levy the general VAT rate on groceries but not on pharmaceuticals or books.

TABLE 33

VAT rates on groceries, pharmaceuticals and books in European Union member states – 2015

(as a percentage)

	Rates on groceries			Rates on pharmaceuticals			Rates on books		
States	**Rate 1**	**Rate 2**	**Rate 3**	**Rate 1**	**Rate 2**	**Rate 3**	**Rate 1**	**Rate 2**	**Rate 3**
Austria	10	—	—	10	—	—	10	20	—
Belgium	6	12	21	6	21	—	6	21	—
Bulgaria	20	—	—	20	—	—	20	—	—
Croatia	5	13	25	5	25	—	5	—	—
Cyprus	5	19	—	5	—	—	5	19	—
Czech Republic	10	15	—	10	—	—	10	21	—
Denmark	25	—	—	25	—	—	25	—	—
Estonia	20	—	—	9	—	—	9	20	—
Finland	14	—	—	10	—	—	10	24	—
France	5.5	10	20	2.1	10	20	5.5	20	—
Germany	7	19	—	19	—	—	7	19	—
Greece	13	—	—	6.5	13	23	6.5	23	—
Hungary	18	27	—	5	27	—	5	—	—
Ireland	0 or 4.8	13.5	23	0	23	—	0	23	—
Italy	4	10	—	10	22	—	4	22	—
Latvia	12	21	—	12	—	—	12	21	—
Lithuania	21	—	—	5	—	—	9	21	—
Luxembourg	3	—	—	3	17	—	3	—	—
Malta	0	—	—	0	—	—	5	—	—
Netherlands	6	—	—	6	21	—	6	—	—
Poland	5	8	23	8	—	—	5	23	—
Portugal	6	13	23	6	—	23	6	—	—
Romania	9	24	—	9	—	—	9	—	—
Slovak Republic	20	—	—	10	—	—	10	20	—
Slovenia	9.5	—	—	9.5	—	—	9.5	—	—
Spain	4	10	—	4	21	—	4	21	—
Sweden	12	25	—	0	25	—	6	25	—
United Kingdom	0	20	—	0	20	—	0	20	—

Source: European Commission, *VAT Rates Applied in the Member States of the European Union*, January 2015.

☐ Tax-free statuses that are less beneficial to the poorest individuals

A recent OECD study[67] indicates that the levying of reduced rates on specific products results in a significant shortfall in revenue from the richest deciles, and the result is consistent for all countries analyzed.

- The choice to levy reduced rates on groceries to help the poorest individuals is obviously not well targeted.
- The same observation can be made in the case of pharmaceuticals, where higher-income deciles tend to benefit more from reduced rates than modest-income deciles.
- With regard to the levying of reduced rates on books, the cost of the tax expenditure is even more concentrated in the high-income decile.

When it comes to groceries, pharmaceuticals and books, the study shows that the richest decile always benefits more from the tax expenditure related to tax reductions than the poorest decile, which tends to prove that the tax-free status does not especially benefit the poorest individuals.

In light of these results, it does not seem that levying zero tax on goods and services is the best approach to account for the reduced ability to pay of modest-income individuals.

Levying the tax and granting support to individuals with a reduced ability to pay would be a better means of supporting modest-income individuals.

---

[67] OECD, *The Distributional Effects of Consumption Taxes in OECD Countries*, OECD Tax Policy Studies, 2014.

5. SPECIFIC TAXATION

☐ The general principle

Specific taxes are calculated according to a unitary rate by quantity sold of certain goods. They are usually intended to recover certain social costs linked to the consumption of the product concerned and to limit its use.

Such taxes are often preferred to other taxes to collect the revenue necessary to fund public services. The objectives set make them more acceptable to society, and they generally have less of an impact on the competitiveness of economic agents.

Québec levies three specific taxes:

- The specific tax on alcoholic beverages
- The specific tax on fuel
- The specific tax on tobacco products

☐ The importance of specific taxation

In 2014-2015, specific taxes on alcoholic beverages, fuel and tobacco products will provide the Québec government with $4 billion in revenue (5% of consolidated revenue).

The proportion of specific taxes included in prices is relatively high, varying from 30.1% for beer to around 67% for wine and tobacco, and sitting at 35.7% for fuel.

TABLE 34

Revenue from specific taxes
(in millions of dollars)

Specific taxes	2013-2014	2014-2015	2015-2016	2016-2017
Alcoholic beverages(1)	552	598	624	631
Fuel	2,331	2,330	2,375	2,410
Tobacco products	1,026	1,108	1,103	1,062
TOTAL	**3,909**	**4,036**	**4,102**	**4,103**

(1) Including $100 million allocated to the Generations Fund in 2014-2015 and 2015-2016. Beginning in 2016-2017, that amount will increase to $500 million annually.

5.1 The specific tax on alcoholic beverages

The specific tax on alcoholic beverages is calculated according to a unitary rate by volume (dollars per litre) that applies to all retail sales of alcoholic beverages in Québec.

The tax is collected by collection officers prior to the final sale to consumers.

On August 1, 2014, the rates applicable were standardized such that since that date the rates are the same regardless of the place of consumption (in the home or in an establishment).

The tax rates are:

- $0.63 per litre for beer
- $1.40 per litre for wine and spirits

TABLE 35

Specific taxes on alcoholic beverages
(in dollars per litre)

	Beer		Wine and spirits	
	Consumption in the home	Consumption in an establishment	Consumption in the home	Consumption in an establishment
Tax since August 1, 2014	0.63	0.63	1.40	1.40

☐ A comparison with neighbouring provinces

Prices in Québec are advantageous compared to those in Ontario and New Brunswick. The price of beer purchased in retail stores is lower in Québec than in the neighbouring provinces. What is more, the price of wine and spirits is competitive in Québec compared to in Ontario and New Brunswick.

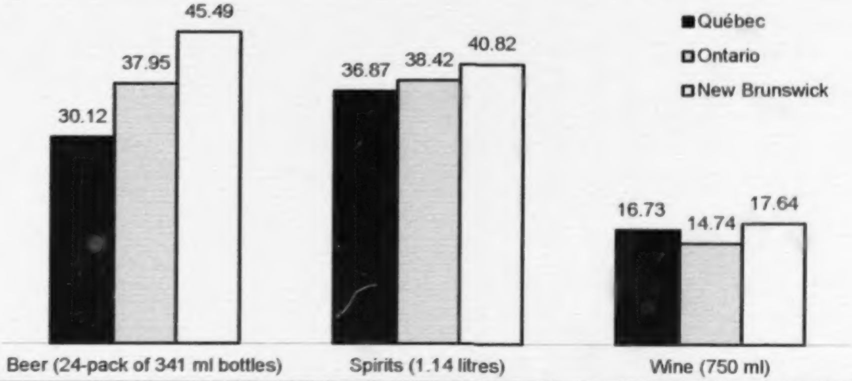
A comparison of the average price of 20 top-selling products in Québec that are available in Ontario and New Brunswick reveals that:

— The price of spirits is lower in Québec than in Ontario and New Brunswick.

— The price of wine is lower in Québec than in New Brunswick but higher than in Ontario.

CHART 24

Comparison of the price of certain alcoholic beverages among the most widely sold in Québec – 2014
(in dollars)



Note: The price of beer in Québec is the minimum price including GST and QST. For wine and spirits, the price indicated is the average price of 20 top-selling products in Québec that are available in Ontario and New Brunswick. Québec tax rates are as at August 1, 2014.

Sources: The websites of the Liquor Control Board of Ontario, Alcool NB Liquor and the Société des alcools du Québec.

5.2 The specific tax on fuel

The specific tax on fuel is calculated according to a unitary rate by volume (cents per litre) that applies to all retail sales of fuel in Québec. The tax is collected by collection officers prior to the final sale to consumers.

Since April 1, 2013, the general rate of the specific tax on fuel has been 19.2 cents per litre for gasoline and 20.2 cents per litre for diesel (uncoloured fuel oil).

The general rate of the fuel tax applicable to gasoline may be increased in certain regions to ensure funding for mass transit services in the territories:

- 3 cents per litre (since May 2010) on gasoline sold in the territory of the Communauté métropolitaine de Montréal, proceeds from which are paid to the Agence métropolitaine de transport (AMT)
- 1 cent per litre (since July 2012) on gasoline sold in the territory of the Gaspésie–Îles-de-la-Madeleine administrative region

Conversely, the general rate of the fuel tax applicable to gasoline and diesel is reduced in certain regions:

- 1 to 8 cents per litre on gasoline sold in regions bordering on another jurisdiction
- 1 to 4 cents per litre in regions bordering on Ontario and New Brunswick
- 2 to 8 cents per litre in regions bordering on the United States
- 0.1 to 4.65 cents per litre on gasoline and diesel sold in regions remote from major urban centres (peripheral and specific regions and adjacent regions)[68]

TABLE 36

Comparison of the different rates of specific tax on fuel in Québec
(in cents per litre)

	Fuel tax rates in Québec
Gasoline	19.2
– Border regions	11.2 to 18.2
– Peripheral and specific regions	14.55 to 19.0
Diesel (uncoloured fuel oil)	20.2
– Peripheral and specific regions	16.38 to 20.1

---

[68] It should be noted that motorists in peripheral and specific regions have also benefited since November 1995 from a reduction (of $52 and $26, respectively) in motor vehicle registration fees applicable to passenger vehicles.

❑ A comparison with other jurisdictions

The specific taxation of fuel in Québec is among the highest in relation to other Canadian and American jurisdictions, more specifically in respect of gasoline and diesel. Only British Columbia levies higher specific taxes than Québec does, because of the levying of a carbon tax.

Furthermore, the sales tax rate of 14.975% applicable to fuel sold in Québec (GST of 5% and QST of 9.975%) ranks second only to that of Nova Scotia (HST of 15%, i.e. GST of 5% and the provincial portion of 10%).

The differences in taxes are reflected in the price paid at the pump in Québec, where significant price differences are noted, particularly in border jurisdictions.

TABLE 37

Comparison of fuel taxation in certain jurisdictions(1)
(in cents per litre, unless otherwise indicated)

	Rate in the province or state	Federal rate	Combined rate	Rate of the general sales taxes	Price difference in relation to Québec(2)
Québec	19.2	10.0	29.2	14.975%	—
Ontario	14.7	10.0	24.7	13.0%	-7.5
New Brunswick	13.6	10.0	23.6	13.0%	-8.8
British Columbia(3)	21.2	10.0	31.2	5.0%	−10.3
Maine	7.9	5.0	12.9	0.0%	−28.1
New York(4)	9.9	5.0	14.9	4.0%	−28.5
New Hampshire	6.3	5.0	11.3	0.0%	−35.5

(1) Exchange rate of CAN$1.085 = US$1 (as of June 14, 2014).

(2) Difference calculated based on a pre-tax price of 95 cents per litre, to which the applicable taxes (specific taxes and general sales taxes) were added.

(3) Also includes the carbon tax (6.67 cents per litre for gasoline and 7.67 cents per litre for diesel).

(4) Includes the state specific tax and a specific tax allocated to towns and villages.

5.3 The specific tax on tobacco products

The specific tax on tobacco products is generally calculated according to a unitary rate by mass (cents per gram) that applies to all retail sales of tobacco in Québec. The tax is collected by collection officers prior to the final sale to consumers.

However, in the case of cigarettes, the tax is calculated according to a unitary rate (cents per cigarette). In the case of cigars, the tax is calculated as a percentage of the taxable price of each cigar (ad-valorem tax). The specific tax on tobacco products is $29.80 per carton of 200 cigarettes.

The following tax rates apply:

— 14.9 cents per cigarette

— 14.9 cents per gram of loose leaf tobacco or leaf tobacco

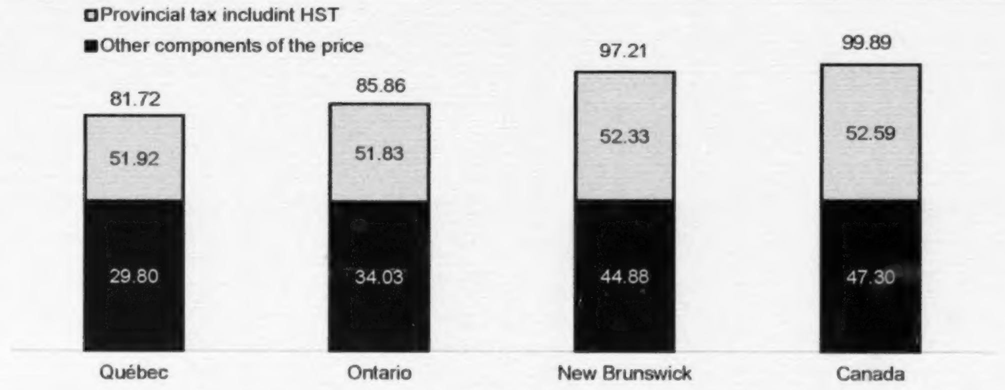
— 80% of the taxable price of each cigar

— 22.92 cents per gram of any tobacco other than cigarettes, loose leaf tobacco, leaf tobacco and cigars

Québec has the lowest effective taxation of tobacco products of any province. The difference is $4.23 compared to Ontario, $15.08 compared to New Brunswick and $17.50 compared to the Canadian average.

CHART 25

Components of the price of a carton of 200 cigarettes
(in dollars)



6. GREEN TAXATION

Québec has implemented a number of green taxation measures that encourage consumers to adopt environmentally friendly behaviours. Together, the measures are generally known as green taxation.

Green taxation measures can take two forms.

- They can be incentives, which are generally tax credits that encourage the desired behaviour.
- More often, however, they are penalties in the form of additional fees or specific taxes, such as the specific tax on fuel, that discourage environmentally harmful behaviours or consumption.

Green taxation frequently uses taxes to influence prices, in order to limit the consumption of goods or activities that produce negative externalities (pollution, congestion, etc.), following the "user-pays" or "polluter-pays" principle. This principle is among those set out in Québec's *Sustainable Development Act* and *Environment Quality Act*.

Green taxation affects a broad range of fields, including transportation, residual materials management and land-use planning.

To support its reflection on the matter, the Committee commissioned a study by the Groupe de recherche appliquée en macroécologie, *Modalités et avantages d'une réforme fiscale écologique pour le Québec : mythes, réalités, scénarios et obstacles*. The study was conducted by Luc Gagnon, Jean-François Lefebvre and Jonathan Théorêt with the collaboration of Réjean Benoit and Michelle Graig.

The study is available in full in Volume 5 of this report (in French only).

☐ The Green Fund

A large number of the current green taxation measures contribute to the Green Fund, which was created in 2006 by the *Act respecting the Ministère du Développement durable, de l'Environnement et des Parcs* to support measures promoting sustainable development.

Green Fund revenues are derived mainly from:

- Charges for the disposal of residual materials
- Annual levies on fossil fuels and other combustibles
- Charges payable for the use of water
- Most recently, the sale of greenhouse gas emission units under the cap-and-trade system for greenhouse gas emission allowances

Charges are used for the purposes for which they are collected, i.e., for measures and/or programs related to residual materials and water management or to fund the fight against climate change.

Charges for the disposal of residual materials

In terms of residual materials, since 2006, operators of disposal sites must pay a charge for each ton of materials to be disposed of.

In 2006, the total charge was $10 per ton. That amount has been raised several times since, and in 2014, it was $21.30 per ton.

- In 2014, the regular rate was $11.52, with an additional charge of $9.78 added to it for the period from October 1, 2010, to December 31, 2023.
- The rates are indexed each year on the basis of the percentage change in the consumer price indexes for Canada, as published by Statistics Canada.

Charges on residual materials are used to fund the Québec Residual Materials Management Policy, which includes the Programme de traitement des matières organiques par biométhanisation et compostage (organic matter treatment program using biomethanation and composting).

In 2014-2015, these charges should raise $115 million for the Green Fund.

Charges payable for the use of water

In terms of water use, since 2011, every person whose water withdrawals are 75 m^3 (75,000 L) or more per day must pay a charge.

In 2012, the charge was $0.0025/$m^3$ of water,[69] except in the following sectors, for which the charge was $0.07/$m^3$ of water:

- The production of water in bottles or other containers, whether the water is intended for human consumption or not
- Beverage manufacturing
- Non-metallic mineral product manufacturing, when water is incorporated into the product
- Pesticide, fertilizer and other agricultural chemical manufacturing, when water is incorporated into the product
- Other basic inorganic chemical manufacturing, when water is incorporated into the product
- Oil and gas extraction

In 2014-2015, these charges should raise $3 million for the Green Fund.

---

[69] The rates are indexed each year on the basis of the average consumer price index, without alcoholic beverages and tobacco products for the 12-month period ending on September 30.

Revenues from the sale of greenhouse gas emission units

In terms of greenhouse gases, on January 1, 2013, the Québec government implemented a cap-and-trade system for greenhouse gas emission allowances (carbon market).

The market was created in partnership with California, through the Western Climate Initiative. The cap-and-trade system for greenhouse gas emission allowances is an environmental regulation that uses market mechanisms to reach a greenhouse gas reduction target.

The system's main advantages are that it ensures:

- The greenhouse gas reduction target is reached.
- Emission reductions occur where they cost least, which improves economic efficiency.

Enterprises that emit more than 25,000 tons of CO_2 equivalent must compensate for their greenhouse gas emissions using emission allowances from the cap-and-trade system for greenhouse gas emission allowances. This has been in effect since:

- 2013 for the industrial and electricity sectors (80 establishments)
- 2015 for fuel distributors (50 establishments)

Revenues from this system go into the Green Fund and are used to support the 2013–2020 Climate Change Action Plan, one of whose objectives is greenhouse gas reduction.

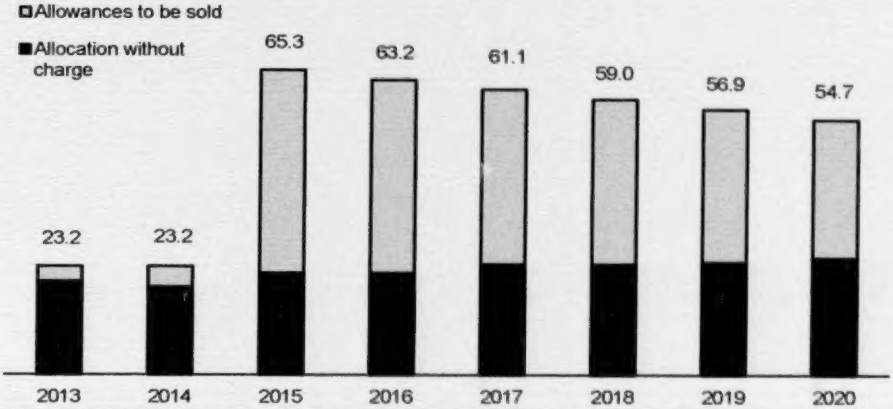
The requirement for Québec emitters to cover their emissions has been in force since January 1, 2013. Three compliance periods are planned: from 2013 to 2014, from 2015 to 2017 and from 2018 to 2020.

In the first period, which began in 2013, the requirement applied only to industrial or electricity production establishments whose annual greenhouse gas emissions were equal to or greater than 25,000 tons of CO_2 equivalent (about 80 establishments). This period was labelled "transitional" because the efforts required were modest.

In the second period, which began on January 1, 2015, the requirement now also applies to fuel distributors if the greenhouse gas emissions attributable to the combustion of that fuel are equal to or greater than 25,000 tons of CO_2 equivalent.

CHART 26

Annual caps and estimated distribution of the greenhouse gas emission units available for allocation without charge versus the emission units available to be sold
(greenhouse gas emission units)



Source: Ministère du Développement durable, de l'Environnement et de la Lutte contre les changements climatiques. Compilation of the Ministère des Finances du Québec.

7. THE PROBLEM WITH COLLECTING SALES TAX ON E-BUSINESS

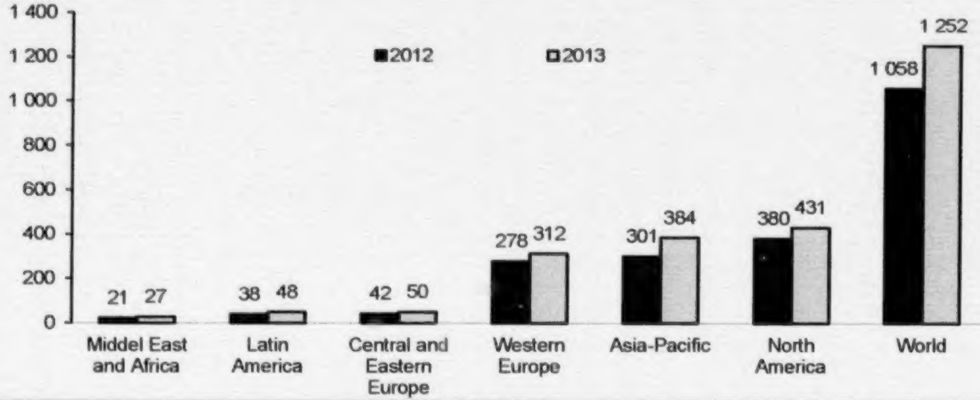
The e-business sector is thriving. It has seen marked growth since the early 2000s and is continuing to grow.

According to eMarketer, online sales worldwide reached US$1,251 billion in 2013, an 18.3% increase from 2012. In terms of sales volume, North America led the pack, followed by the Asia-Pacific region and Western Europe.

According to experts, e-business should continue to expand in the coming years. Essentially, it will be supported by the emerging economies of Asia, and China in particular.

CHART 27

Global online retail sales
(billions of US dollars)



Note: Sales made by companies to consumers. Data includes purchases of goods and services, leisure activities and trips that were made over the Internet or other method and regardless of the method of payment.
Source: eMarketer.

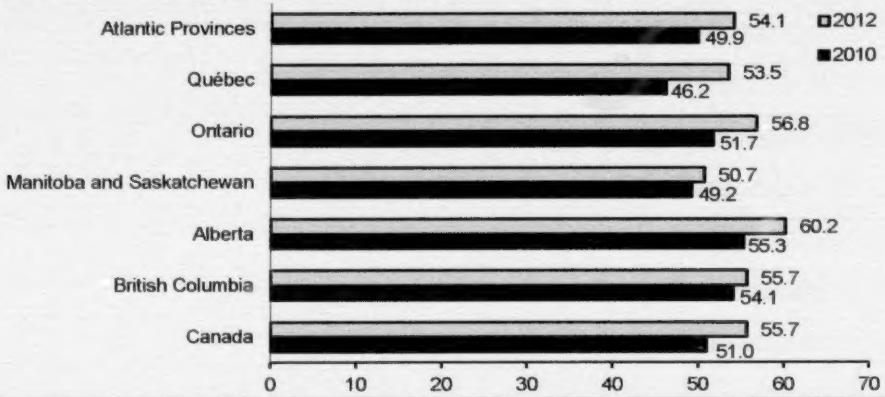
☐ Rapid rise in online transactions

There has been a rapid rise in online transactions. Statistics Canada's Canadian Internet Use Survey shows the rise of e-business sales between 2010 and 2012.

- Of Canadians aged 16 and over who used the Internet in 2012, 55.7% purchased a product or service online, which was an increase of 4.7 percentage points from 2010.
- In Québec, the rise was even more pronounced. Of the people 16 and over who used the Internet, 53.5% made an online purchase, which correlates to an increase of 7.3 percentage points between 2010 and 2012.
- Among the Canadian provinces, Alberta (60.2%) and Ontario (56.8%) led in terms of the proportion of the population that purchased products or services online in 2012.

CHART 28

Individuals who purchased a good or service online
(as a percentage of those who used the Internet)



Sources: Institut de la statistique du Québec and Statistics Canada.

☐ Behaviour more common in younger and more educated people

In 2012, the proportion of Internet users in Québec who purchased products or services online varied depending on sex, age and education.

In Québec:

- The proportion of men who made an online purchase was 57.8%; for women, this number was 49.2%.
- People between ages 25 and 34 (69.4%) made the most online purchases in 2012.
- People with higher levels of education made more online purchases in 2012.
- In fact, in Québec, 64.4% of people who had a university degree made online purchases, compared to 34.2% of people who completed secondary school at most.

TABLE 38

Profile of people in Québec who made online purchases
(as a percentage of people in Québec aged 16 and over who used the Internet)

	2012
Sex	
Male	57.8
Female	49.2
Age group	
16 to 24	56.3
25 to 34	69.4
35 to 44	56.4
45 to 54	54.3
55 to 64	42.2
65 and over	28.0
Level of education	
Secondary school or less	34.2
College studies or university certificate	57.6
University degree	64.6
TOTAL	**53.5**

Sources: Institut de la statistique du Québec and Statistics Canada.

☐ Value of online purchases

Aside from the occasional investigations or studies, little data exists on the value of online purchases.

According to Statistics Canada, in 2012, the total value of online purchases made by people in Québec was $3.1 billion, which was 16.5% of all online purchases made in Canada.

In Québec, the value of online purchases equalled 2.1% of the taxable consumption of goods and services[70] ($148.1 billion).

According to another estimate,[71] online purchases in Québec equalled $6.8 billion in 2012, which was 4.6% of the taxable consumption of goods and services.

☐ Issue with collecting taxes

E-business raises an issue in terms of tax collection by the tax jurisdictions.

Theoretically, online transactions are subject to the general tax rules of current tax laws. However, in practice, it is difficult to apply those rules to online transactions when the transactions are made with suppliers outside Québec.

In numerous cases, Québec collects no QST when a good or a service is purchased online from a supplier located outside Québec.

— Revenu Québec estimated that the Québec government experienced $165 million in tax losses in 2012 related to online purchases that people in Québec made from suppliers outside Canada.

— It is hard to estimate the losses related to online purchases that people in Québec made from suppliers in other provinces, but the amount is likely significant. Revenu Québec's estimate was $300 million.

These numbers must be treated with caution, since little data is available concerning e-business and the related tax losses.

With the e-business sector growing rapidly, related tax losses should continue to grow significantly over the coming years, in the absence of adequate measures to recover the taxes normally owed.

---

[70] Total consumption of goods and services, excluding food and rent.

[71] This estimate was produced by the Centre facilitating research and innovation in organizations with information and communication technology.

PART 8:
WEALTH TAXES, SOCIAL SECURITY CONTRIBUTIONS AND ELECTRICITY RATES

The eighth topic addressed by the Committee was the main characteristics of three sources of revenue not yet addressed, namely:

— Wealth taxes

— Social security contributions

— Rates for public services, and more specifically, electricity rates

1. WEALTH TAXES

In Québec, wealth taxes essentially take two forms:

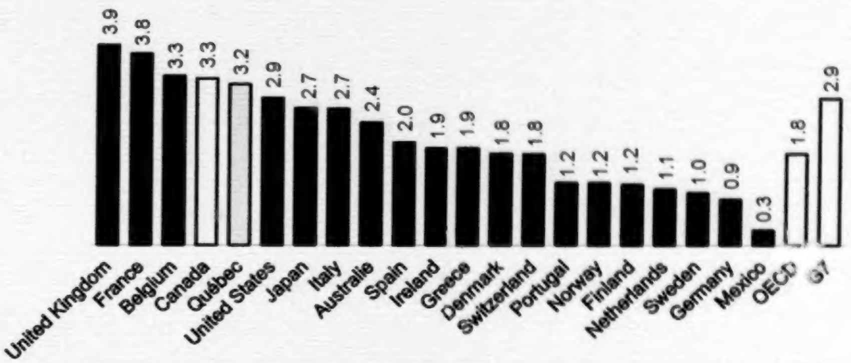
- Property taxes
- Taxes on real estate transactions

☐ The weight of wealth taxes

Wealth taxes represent a total of 3.2% of Québec's GDP, which is a weight similar to the one observed in the rest of Canada. In the United States, wealth taxes represent 2.9% of GDP.

The level of wealth taxes levied in Québec is nearly twice the average for OECD countries.

CHART 29
The weight of wealth taxes – 2012
(as a percentage of GDP)



Sources: OECD, data warehouse as at January 30, 2015, and Institut de la statistique du Québec, *Comptes économiques des revenus et dépenses du Québec* (2014 edition).

2. SOCIAL SECURITY CONTRIBUTIONS

Social security contributions can be paid either by the employer or jointly by the employer and the employee.

The revenues derived from social security contributions in Québec essentially come from the following sources:

- Québec Parental Insurance Plan
- Commission de la santé et de la sécurité du travail
- Commission des normes du travail
- Québec Pension Plan
- Employment insurance

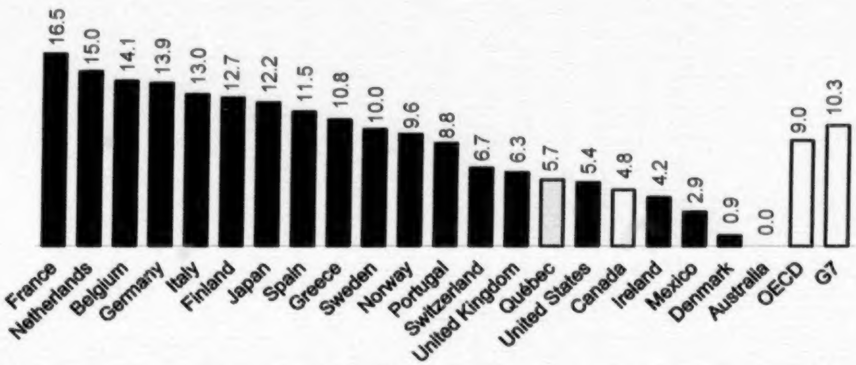
☐ The weight of social security contributions

Social security contributions represent 5.7% of Québec's GDP, compared with 4.8% for Canada as a whole. The weight of social security contributions in Québec is similar to that in the United States.

However, social security contributions in Québec have a much smaller weight than the average observed in OECD countries.

CHART 30

The weight of social security contributions – 2012
(as a percentage of GDP)



Sources: OECD, data warehouse as at January 30, 2015, and Institut de la statistique du Québec, *Comptes économiques des revenus et dépenses du Québec* (2014 edition).

3. RATES FOR PUBLIC SERVICES: ELECTRICITY RATES

Taxation and rates for public services are interrelated.

To better understand this interrelation, the Committee asked the Center for Interuniversity Research and Analysis of Organizations (CIRANO) to carry out a study on the rates of public services. This study, entitled *La tarification des services publics : un mode de financement à privilégier au Québec*, was conducted by Claude Montmarquette and Matthieu Strub with the collaboration of Louis Lévy-Garboua.

The study is available in full in Volume 5 of this report (in French only).

CIRANO was asked to assess the economic importance of rates in funding public services and their relevance in the current context. The study also explains the advantages and disadvantages of rates as a funding tool.

The Committee prioritized two public services, namely childcares services and electricity.

- Childcare services are presented in detail in Volume 4 of this report.
- This section addresses only electricity rates.

3.1 Electricity rates

Electricity, and mainly hydropower, is a source of great wealth for Québec and its economy. Québec has several plants and a transmission and distribution system that meet the electricity needs of consumers.

In Québec, Hydro-Québec's electricity sales are divided among residential customers (49.9%), business customers (37%) and industrial customers (13.1%).

Over the past 15 years, the demand from residential and business customers has increased, while the demand from industrial customers has decreased, notably due to a decline of certain industries such as pulp and paper.

- The demand from residential customers has increased due to demographics and also due to an increase in sales per customer and an increase in the number of connections per capita.
- Reverse trends were noted for business customers, with fewer connections per capita and less electricity consumption per connection.

Rates are cross-subsidized between industrial and business customers and residential customers, in accordance with section 52.1 of the *Act respecting the Régie de l'énergie*.

- Residential customers benefit from electricity rates that are lower than the cost of their service.
- Residential customers are therefore subsidized by business and industrial customers.

❑ Lower rates in Québec

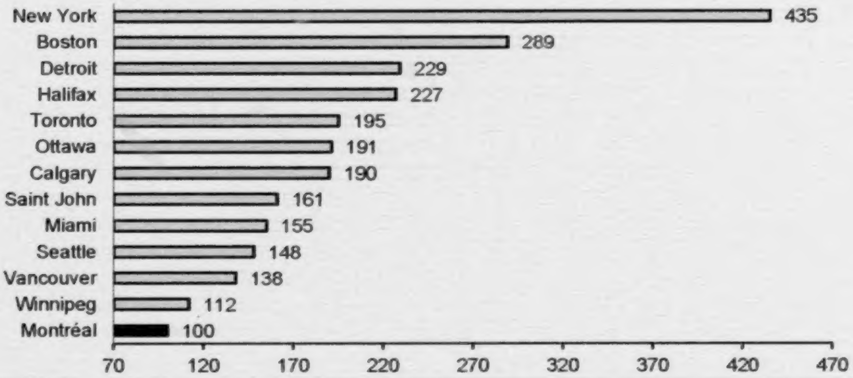
Average residential electricity rates are lower in Québec than elsewhere in North America. For example, on April 1, 2014, the average residential electricity rate in Toronto was almost double the rate in effect in Montréal. The difference was more pronounced with the rate in New York City, one of Québec's trade partners for electricity exports.

These electricity rates remain competitive, despite the indexation of heritage pool electricity costs and other rate hikes authorized by the Régie de l'énergie.

CHART 31

Comparison of average electricity prices as at April 1, 2014 – Residential customers

(Montréal = 100)



Source: Hydro-Québec, *Comparison of Electricity Prices in Major North American Cities – Rates in Effect April 1, 2014*.

If we applied Ontario's rate structure to Québec, the prices would be 5.04 ¢/kWh higher than the current average.

TABLE 39

Application of Ontario's electricity rate parameters to Québec – As at April 1, 2014

(¢/kWh)

Customers	Average price	Average price after applying Ontario's rate structure	Difference
Residential	7.68	13.98	6.30
General	7.91	10.60	2.69
Large industries	4.77	10.97	6.20
TOTAL	**7.17**	**12.20**	**5.04**

☐ History of rate increases

In Québec, electricity rates remained constant from 1998 to 2003, and then increased from 2004 to 2010, with an average increase of 2.1% per year.

— For 2011 and 2012, the Régie de l'énergie ordered two rate decreases: a first decrease estimated at 0.41% as at April 1, 2011, and a second decrease of 0.45% for the year starting on April 1, 2012.

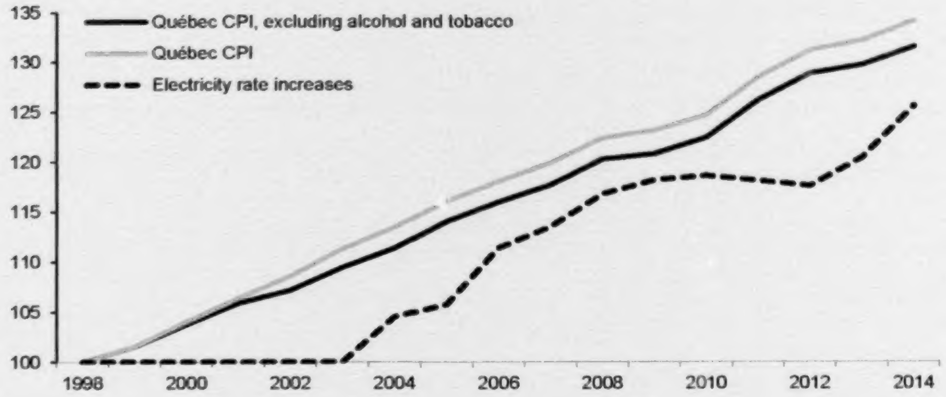
— Then, increases of 2.41% and 4.3% were authorized for 2013 and 2014 respectively.

In general, aside from the decreases of 2011 and 2012, the rate increases authorized were higher than the consumer price index (CPI) in Québec. For instance, the increase authorized for 2014-2015 was 4.3% while the Québec CPI for the 2014 calendar year was estimated at 1.3%.

The increase requested by Hydro-Québec in its recent 2015-2016 rate application is 3.9%, whereas the Québec CPI is estimated at 2.1% for the 2015 calendar year.

CHART 32

History of electricity rate increases in Québec compared with the Québec CPI
(1998 = 100)



☐ Optimization of electricity rates

The Committee asked a Québec expert on the optimization of electricity rates to conduct an external study to guide its reflection on the topic.

The study was carried out for the Committee by Pierre-Olivier Pineau of the Chair in Energy Sector Management at HEC Montréal and is entitled *L'électricité au Québec : Faire entrer le secteur dans le 21^e siècle*. The study is available in full in Volume 5 of this report (in French only).

The study describes the current situation of the electricity sector in Québec and the situation prevailing in other countries, including the United States and Norway. The author also gives the Committee topics for reflection with regard to resource management optimization.

PART 9:
COMPETITIVENESS OF THE PERSONAL TAX SYSTEM

The ninth topic addressed by the Committee was the competitiveness of the personal tax system.

This section examines:

— The personal tax burden

— Family disposable income

1. THE PERSONAL TAX BURDEN

The difference in tax burden between Québec and the other provinces is measured by applying to Québec taxpayers the tax structure of the compared jurisdiction to determine the burden that Quebecers would have to bear under the taxation system of the jurisdiction in question.

A model for measuring the difference in tax burden

The difference in tax burden can be estimated using a microdata model that takes into consideration the deductions of the different provincial and federal systems, such as the partial inclusion of capital gains and the deduction for workers, as well as non-refundable tax credits such as the amount for a person living alone, the age amount and the amount for retirement income.

The model also takes into consideration the tax rate schedules of the jurisdictions being analyzed as well as the portion of refundable tax credits used to cancel out taxes. Refundable tax credits for families, such as the tax credit for child assistance, the tax credit for childcare expenses, the tax credit respecting the work premium and the medical expense tax credit, are among those included in the model. The model also considers elements associated with the tax levy base, such as the health care contributions of Ontario, British Columbia and Québec.

❑ Comparison of tax burden in Canada

When we apply to Québec the tax structure in effect in other provinces, we see that Québec has a heavier tax burden and that the gap is widening.

- In 2015, only the tax structures of Nova Scotia and Prince Edward Island would have generated more revenues if they had been applied to Québec.
- The application of Alberta's structure would have created the most significant difference, namely $9.9 billion.
- The application of Ontario's structure would have subtracted nearly $6.5 billion in tax revenues.

TABLE 40

Difference in tax burden between Québec and other provinces after applying to Québec the tax structures of other provinces
(in millions of dollars)

	2011	2015
Alberta	7,904	9,944
Ontario	5,285	6,489
Saskatchewan	4,929	6,390
British Columbia	5,697	6,244
Newfoundland and Labrador	3,393	4,714
New Brunswick	4,485	3,082
Manitoba	101	445
Nova Scotia	−259	−313
Prince Edward Island	−581	−459
AVERAGE DIFFERENCE	**3,439**	**4,059**

Note: Difference in tax burden according to taxation forecasts as at January 1, 2015. The difference takes into consideration the health contribution and family assistance measures. The 16.5% Québec abatement is subtracted from the difference in tax burden.

■ Québec and Ontario

When we compare Québec's tax burden with Ontario's, we see a favourable difference for Québec taxpayers with an income of up to $25,000. For those with a higher income, the burden of Québec taxes is still heavier than that of Ontario.

— For some individuals with an income between $40,000 and $110,000, the difference in burden with Ontario exceeds 50%.

— Over the $100,000 income line, the difference shrinks but remains considerable.

— The difference is nearly 20% for an income of $300,000 and nearly 15% for an income of $400,000, and it still exceeds 10% for a total income of $500,000.

Overall, 72.4% of the difference in tax burden with Ontario is borne by taxpayers whose total income falls between $25,000 and $110,000. About $1.9 billion of the $6.5 billion is levied on taxpayers with a total income between $50,000 and $75,000.

When we compare the tax rate schedules of Québec and Ontario, we can see that marginal rates are practically the same beyond $220,000.

CHART 33

Difference in tax burden between Québec and Ontario – 2015
(as a percentage)

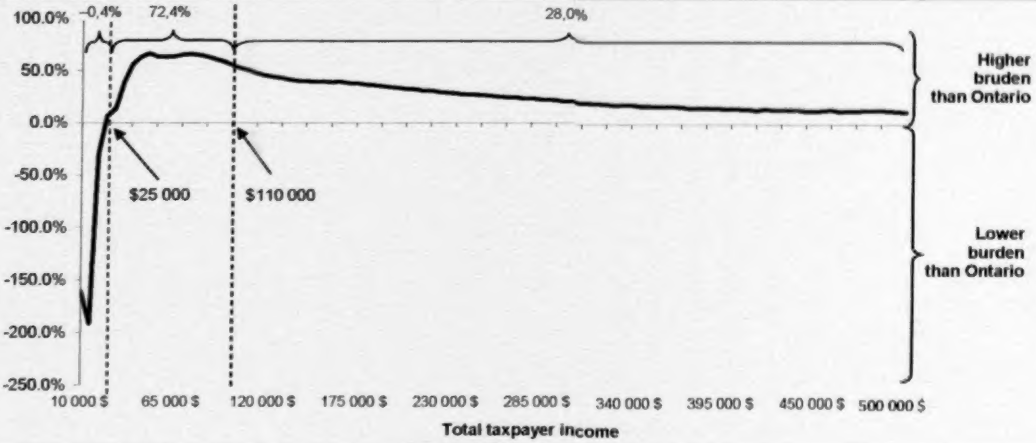


TABLE 41

Difference in tax burden between Québec and Ontario – 2015

(in millions of dollars)

	Difference
Less than $30,000	31
$30,000 to $50,000	1,156
$50,000 to $75,000	1,908
$75,000 to $100,000	1,397
$100,000 to $150,000	1,072
$150,000 to $200,000	377
$200,000 to $250,000	177
$250,000 to $500,000	263
$500,000 or more	108
TOTAL	**6,489**

2. FAMILY DISPOSABLE INCOME

The method presented here consists of comparing the disposable income of families with children in Québec to that of families in the rest of Canada, considering income taxes, social security contributions and government benefits, in addition to net childcare costs paid by households.

In Québec, children attend reduced-contribution childcare services. In other provinces, childcare costs are an average of $35 per day per child.

In the table below, we see that the situation is advantageous except for high-income taxpayers

- With an income of $25,000, the difference with the Canadian average is more than 45%.
- Even with a family income of $100,000, the difference in disposable income is positive in Québec.

The main reason for this is reduced-contribution childcare services.

When considering the announced changes to the childcare rate, the results show that the situation still remains advantageous for Québec, even for a family with an income of $100,000.

If we apply it to all of 2015, the new childcare service rate reduces the disposable income of this family by about $1,600.

TABLE 42

Difference in disposable income with other provinces for a couple with two children – 2015
(in dollars)

		Without adjusting childcare costs			Including adjusted childcare costs		
	Canadian average(1)	**Québec**	**Difference ($)**	**Difference (%)**	**Québec**	**Difference ($)**	**Difference (%)**
25,000	28,060	41,226	13,166	46.9	41,226	13,166	46.9
50,000	37,190	47,385	10,196	27.4	47,385	10,196	27.4
75,000	50,522	60,789	10,267	20.3	60,485	9,963	19.7
100,000	66,605	73,532	6,928	10.4	71,873	5,269	7.9
150,000	97,808	102,693	4,885	5.0	97,765	–43	0.0

Note: Couple with two children (aged 3 and 4) with reduced-contribution childcare costs and two equal incomes.
(1) Canadian average excluding Québec. Includes the federal deduction for childcare expenses.

PART 10:
COMPETITIVENESS OF THE CORPORATE TAX SYSTEM

The tenth and last topic addressed by the Committee was the competitiveness of the corporate tax system.

This section examines:

- Marginal effective tax rates
- The competitiveness of Québec and its tax system
- The use of certain tax credits

1. MARGINAL EFFECTIVE TAX RATES

A classic method for measuring the weight of taxation on new corporate investments in a country consists of calculating the marginal effective tax rate of a typical investment.

❑ The marginal effective tax rate

The marginal effective tax rate is the portion of the rate of return of a new investment that goes towards profits tax, capital tax, input taxes and other tax provisions, such as capital cost allowance rates, investment tax credits and accounting methods for inventories.

The lower the marginal effective tax rate, the higher the after-tax return on an investment will be.

The estimation of the marginal effective tax rate takes into account the entire range of taxes:

- Corporate income tax
- Capital tax
- Sales taxes on certain capital goods
- Capital cost allowance rules and the difference between the capital cost allowance and economic depreciation
- The deductibility of certain taxes and financing charges (interest)
- Accounting methods for inventories

❑ Comparison with other provinces

In 2014, Québec businesses benefited from a marginal effective tax rate of 14.7%, i.e. a rate below that observed in Ontario, Alberta and, on average, in Canada.

Québec's marginal effective tax rate compares favourably with the rate observed in the United States and that observed, on average, in OECD countries.

This low marginal effective tax rate is explained mainly by the investment tax credit for manufacturing and processing equipment and the accelerated capital cost allowance for manufacturing and processing equipment, which reduces the marginal effective tax rate to 4.9% for the manufacturing sector.

In contrast, other sectors of the economy have seen their marginal effective tax rate reach 19.5%.

❑ International comparison

Between 2005 and 2013, the marginal effective tax rate on investments decreased by 2.7 percentage points on average in OECD countries.

Two thirds of jurisdictions lowered their marginal effective tax rates on investments, and only four jurisdictions increased them by more than one percentage point. The biggest decreases were observed in Québec (−20.9 percentage points) and in Canada (−20.2 percentage points).

Note, however, that Québec and Canada were among the OECD jurisdictions with the highest marginal effective tax rate on investments in 2005.

Several small countries such as Belgium, Denmark, Finland, Ireland, the Netherlands, Sweden and Switzerland have a low rate on the capital invested by businesses.

CHART 34

Marginal effective tax rates on capital – 2014
(as a percentage)

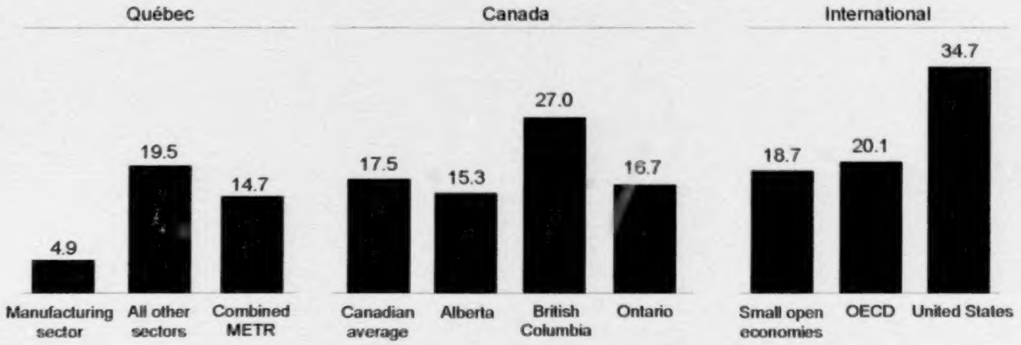


TABLE 43

Change in the marginal effective tax rate on investment from 2005 to 2013

	2005 (%)	2013 (%)	Change (in percentage points)
Turkey	10.9	5.7	−5.2
Chile	7.3	7.7	0.4
Slovenia	15.2	9.8	−5.4
Ireland	10.1	10.1	0.0
Czech Republic	18.0	12.7	−5.3
Iceland	18.0	14.2	−3.8
Poland	14.6	14.6	0.0
Israel	19.5	15.0	−4.5
Québec	**36.1**	**15.2**	**−20.9**
Slovak Republic	12.7	15.7	3.0
Hungary	14.7	16.1	1.4
Sweden	20.9	16.1	−4.8
Estonia	20.2	17.1	−3.1
Luxembourg	19.9	17.3	−2.6
Mexico	17.4	17.4	0.0
Finland	18.7	17.5	−1.2
Netherlands	22.3	17.5	−4.8
Switzerland	18.0	17.5	−0.5
Greece	17.5	18.1	0.6
Belgium	23.5	18.5	−5.0
Canada	38.8	18.6	−20.2
Denmark	21.7	19.1	−2.6
New Zealand	20.5	21.6	1.1
Portugal	19.6	22.9	3.3
Germany	34.0	24.4	−9.6
Norway	24.4	24.4	0.0
Italy	33.5	24.5	−9.0
Australia	25.9	25.9	0.0
United Kingdom	30.0	25.9	−4.1
Spain	30.3	26.0	−4.3
Austria	26.2	26.2	0.0
Japan	31.5	29.3	−2.2
Korea	32.8	30.1	−2.7
France	35.4	35.2	−0.2
United States	35.9	35.3	−0.6
OECD	22.4	19.6	−2.7

Source: Jack Mintz and Duanjie Chen, "2013 Annual Global Tax Competitiveness Ranking: Corporate Tax Policy at a Crossroads", *SPP Research Papers*, Vol. 6, No. 35, University of Calgary, The School of Public Policy, November 2013.

2. THE COMPETITIVENESS OF QUÉBEC AND ITS TAX SYSTEM

Year after year, Québec is among the jurisdictions with the lowest location and operating costs according to KPMG's Competitive Alternatives model.

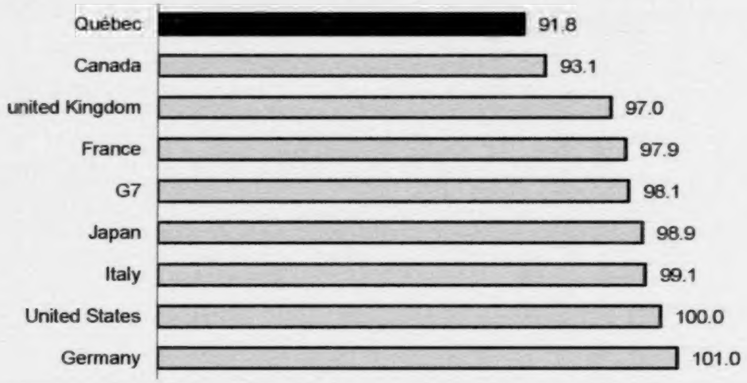
Since the end of the 1990s, the KPMG accounting firm has been periodically conducting international comparisons of the costs of locating and operating a business and certain other competitiveness factors in different cities. The firm's latest study compares the start-up and operating costs of typical projects for 19 commercial activities, including 12 in the manufacturing sector and 7 in the service sector, over a 10-year period starting in 2014. The comparisons were conducted for over 100 cities in 10 countries.

The study makes it possible to measure the combined impact of 26 significant cost components that are likely to vary depending on geographic location. The main cost components other than taxation are labour, rent for facilities, transportation and public utilities (electricity, gas).

In 2014, location costs in Québec were 8.2% lower than in the United States and slightly below those observed, on average, in Canada.

CHART 35

Business location and operating costs – 2014
(index: United States = 100, average of 19 sectors)



Sources: KPMG's Competitive Alternatives model and Ministère des Finances du Québec.

This picture of Québec's tax competitiveness is less positive when we exclude tax incentives.

The chart below is based on KPMG's model, as amended to analyze only the impact of taxation in the different jurisdictions. For this purpose, the taxation of each province shown and of the United States was applied to the same cost structure, namely that of Montréal. In other words, only taxation varies between the jurisdictions compared.

As for the simulation done using tax credits, we can see that total fiscal costs are similar in Québec and in the other Canadian provinces.

The picture is different when tax incentives are excluded from the simulation:

— Total fiscal costs in Québec increase by 23%.

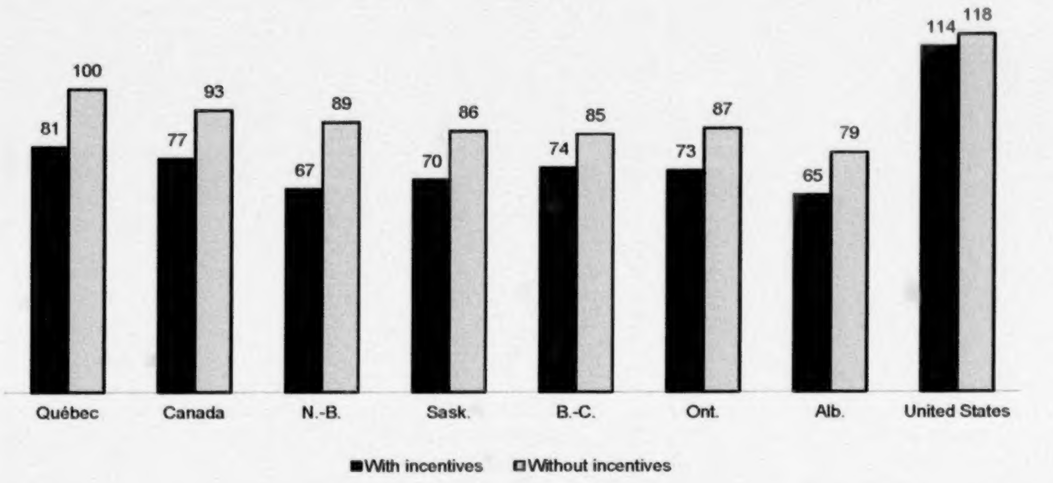
— Total fiscal costs in Québec are 7.5% higher than the Canadian average.

— Compared with Ontario, total fiscal costs in Québec are 11% higher when we include tax incentives in the simulation and 15% higher when we exclude them.

These results show that taxation is advantageous for Québec businesses that benefit from tax incentives (less than 5% of businesses), while businesses that do not benefit from tax credits (95% of businesses) are at a disadvantage.

CHART 36

Tax competitiveness index based on Montréal costs
(index: Québec without tax incentives = 100, average of 19 sectors)



Sources: KPMG's Competitive Alternatives model and Ministère des Finances du Québec.

3. THE USE OF CERTAIN TAX CREDITS

The following credits are analyzed:

- The refundable tax credit for scientific research and experimental development
- The tax credit for the development of e-business
- The tax credit for the production of multimedia titles

❑ The refundable tax credit for scientific research and experimental development

There are four major types of expenditure-based research and development (R&D) tax incentives:

- The tax credit for R&D expenditures, which can be for labour expenditures incurred in R&D (for example in Canada) or for additional R&D expenditures over the level of previous years (for example in the United States), or be based on a hybrid formula that includes a basic rate on total volume and an increased rate for additional expenditures.
- The super allowance for R&D expenditures.
- The accelerated depreciation of capital.
- Payroll tax deductions.[72]

TABLE 44

Expenditure-based tax incentives

R&D tax credit				
Volume	**Incremental/hybrid**	**R&D tax allowance**	**Accelerated depreciation of capital**	**Social security / payroll withholding tax**
Australia, Austria, Belgium (incompatible with allowance), Canada, Chile, Denmark, France, Norway, Hungary	Ireland (hyb.), Italy, Japan (hyb.), Korea (hyb.), Portugal (hyb.), Spain (hyb.), United States (incr.)	Belgium, Czech Republic, Finland, Hungary, Iceland, Netherlands, Slovenia, Slovak Republic, Turkey (hybrid), United Kingdom	Belgium, Canada, Chile, Denmark, France, Israel, Poland, Turkey, United Kingdom	Belgium, France, Netherlands, Hungary, Turkey
Treatment of excess claims (refund or carry-forward)				
Refund				
Australia (SMEs), Austria, Belgium, Canada (SMEs), Denmark, France (SMEs), Norway	Ireland	United Kingdom		Automatic refund through wage system
Carry-forward				
Australia, Belgium, Canada, Chile, France	Ireland, Japan, Korea, Portugal, Spain, United States	Belgium, Czech Republic, Finland, Netherlands, Slovenia, Slovak Republic, Turkey, United Kingdom	Country-specific loss carry-forward provisions apply	Not applicable

Sources: OECD and KPMG.

---

[72] KPMG, *Le soutien fiscal à la R-D au Québec – État des lieux et analyses comparatives avec d'autres territoires*, December 2014, available in Volume 5 of this report (in French only).

Canada positions itself favourably in terms of R&D tax support.

CHART 37

R&D tax treatment: Tax subsidy rate for US$1 of R&D, SMEs – 2013(1)

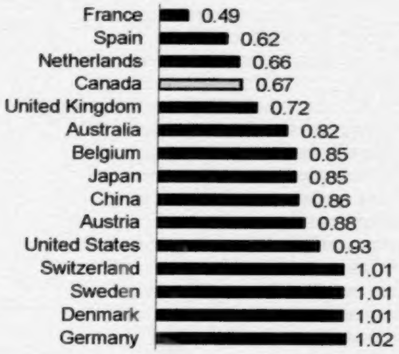
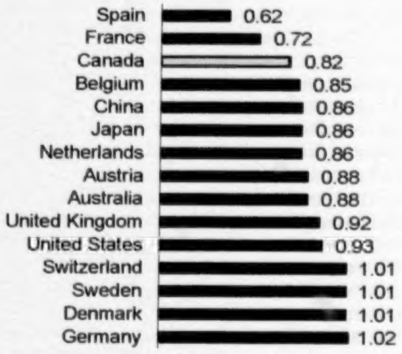


CHART 38

R&D tax treatment: Tax subsidy rate for US$1 of R&D, large enterprises – 2013(1)



(1) The B index is the method generally used by the OECD to compare the tax support measures of different jurisdictions. It represents the net cost after tax of $1 invested in R&D. It takes into consideration R&D tax credits and income deductions. Countries that provide generous R&D tax incentives have a B index under 0.9. Countries with a B index between 0.9 and 1 offer average tax incentives, while those with a B index over 1 provide little to no R&D tax incentives.

Source: OECD, *OECD Science, Technology and Industry Scoreboard 2013*.

☐ The tax credit for the development of e-business

The following information was taken from the study *Revue des programmes de crédits d'impôt à la Nouvelle Économie,*[73] which is available in full in Volume 5 of this report (in French only).

The study presents the following findings:

— Competition between jurisdictions to attract private investment in the information and communications technology (ICT) sector is especially intense.

— Public policies meant to support the ICT sector are widespread throughout the world.

— Several jurisdictions support this sector, mainly through direct subsidies and also through tax measures.

The study mentions that several countries have implemented strategies to support infrastructure, digital technology, job creation and skills in ICTs.

— In Canada, no other province offers tax measures that are comparable to the tax credit for the development of e-business.

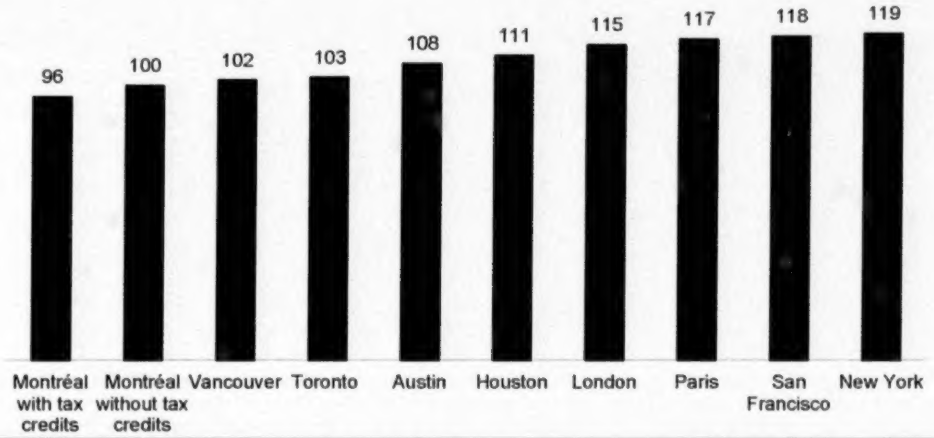
— In the United States, only Louisiana offers a tax credit that is more advantageous than the tax credit for the development of e-business.

Despite the assistance it provides, Québec is not able to compete with some emerging countries such as China and India for certain activities related to low-value-added technology.

However, Québec is among the most competitive regions of North America in terms of operating costs, even if we take away the tax credit.

CHART 39

Total software development costs – 2014
(index: Montréal without tax credits = 100)



Source: E&B Data, *Revue des programmes de crédits d'impôt à la Nouvelle Économie*, December 2014, p. 20.

---

[73] E&B Data, *Revue des programmes de crédits d'impôt à la Nouvelle Économie*, December 2014.

☐ The tax credit for the production of multimedia titles

The following information was also taken from the study *Revue des programmes de crédits d'impôt à la Nouvelle Économie*,[74] which is available in Volume 5 of this report (in French only).

On a global scale, the industry has had strong growth over the last 20 years and should foreseeably continue to grow at a significantly higher rate than the economy. There is no sign of saturation.

By positioning itself quickly on the market through its tax credits, Québec has been able to attract foreign businesses that have given it international visibility.

— Even though several Canadian provinces have followed suit, Québec is still ahead of the rest of Canada.

— Compared with other western jurisdictions, Québec's tax assistance remains advantageous.

— Québec has been a forerunner.

— The majority of programs that exist elsewhere in the world have been introduced recently.

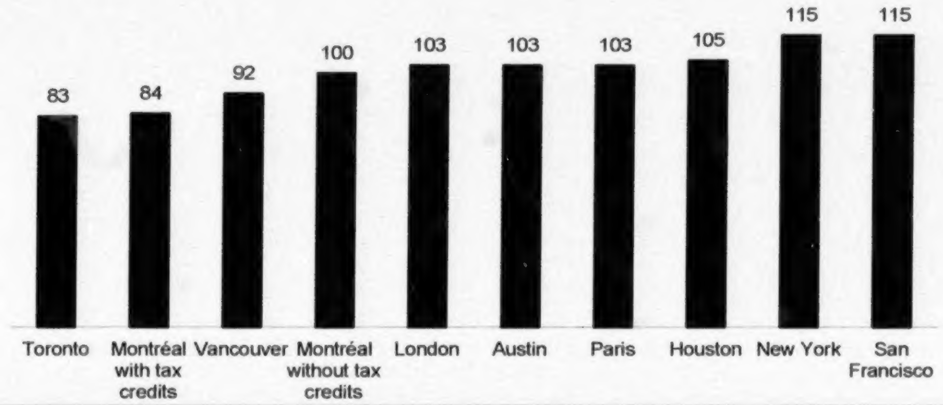
Ontario is Québec's main competitor in the video game industry. Tax assistance in Ontario is now more competitive than the assistance offered in Québec.

In Canada, Québec has the second best overall offer after Ontario, considering tax advantages and the availability of labour.

In the United States, a dozen states offer assistance that can reach 30% or more. However, the basic rate does not exceed 25% in any of the states. In total, 19 states provide tax assistance in the video game industry. In Europe, France (20%) and Great Britain (25%) are the main jurisdictions that offer tax assistance in the video game industry.

CHART 40

Total video game production costs – 2014
(Montréal without tax credits = 100)



Source: E&B Data, *Revue des programmes de crédits d'impôt à la Nouvelle Économie*, December 2014, p. 56.

---

[74] E&B Data, *Revue des programmes de crédits d'impôt à la Nouvelle Économie*, December 2014.

FOCUSING ON QUÉBEC'S FUTURE

**Commission
d'examen
sur la fiscalité**

Québec